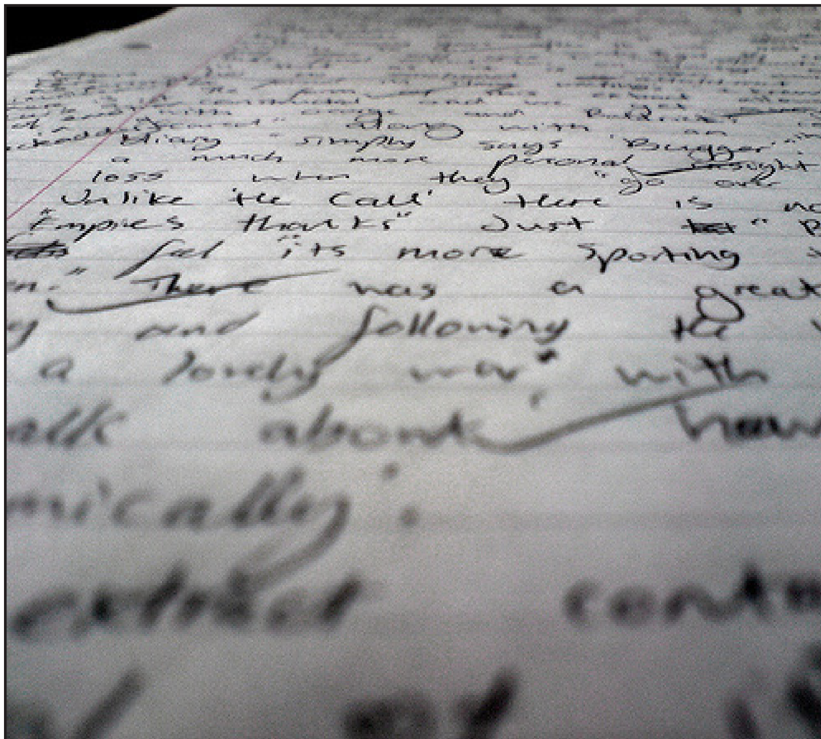
Retirement Plan Sponsors' Ideas that Looked Good on Paper at the Time

By Ary Rosenbaum, Esq.

Whether it's political decisions, product introductions, or military calculations, there are some ideas that looked good on paper, but failed miserably in execution. So while the Argentinean decision to invade the Falkland Islands or the introduction of Crystal Pepsi (great idea until you tasted it) looked great on paper, they were unmitigated flops because the decision makers made costly errors on faulty assumptions. In its operation as a plan sponsor, employers can make decisions on their retirement plan that look like great ideas, but will be potential disasters if executed. This article should serve as a guide for plan sponsors to dissuade them from making decisions that may come back to haunt them.



Not Hiring a Financial Advisor

Too many plan sponsors think they can go it alone. They think that if their plans have investments that are participant directed, there is no need for a financial advisor because they can certainly select 12-15 mutual funds out of 7,000. The role of a financial advisor is just not to pick investment options; it's to help plan sponsors with the fiduciary process. Simply picking out investment options aren't enough, the fiduciary process for a participant directed plan requires an investment policy statement (IPS), review and potential replacement of the investment options against the IPS, and investment education and/or advice to plan participants. Who is the best person to handle that process? The plan sponsor simply can't do it alone, so the services of a financial advisor are invaluable. If the retirement plan has its investments directed by a trustee, the services for a financial advisor are now even more invaluable.

Only using one Plan Provider

This one always gets me in trouble. While the idea of one stop shopping is great for picking up the groceries, clothing, and electronics, it's not ideal for retirement plan services. Picking one provider to serve as the third party administrator (TPA), financial advisor, and provider for plan document services is a potential recipe for disaster. The reason is rather simple; it's never a good idea to put all your eggs in one basket. Hiring plan providers is a fiduciary function, so hiring a poor plan provider can result in a breach of fiduciary duty which will result in liability. The best way to mitigate liability is to hire at least two plan providers who are independent from each other because that will create a system of checks and balances. If a plan sponsor only selects one plan provider to handle it all, who will make sure that the plan provider is doing their job? The plan sponsor? Not if they don't have the background in retirement plans. The beauty of having independent plan providers is if one provider doesn't meet the standards of a competent plan provider, then they can easily be jettisoned. However, if a one stop shop provider is faulty in one area of their practice (like their plan document services), it's much harder to jettison one of their services without threatening the entire plan provider relationship. Thanks to fiduciary responsibility and liability, hiring a one stop shop plan provider is a greater idea on paper than it is in actuality.

Assuming your Plan provider is doing their job

In the movie Austin Powers, Mike Myers as Dr. Evil said: "I'm going to leave them alone and not actually witness them dying, I'm just gonna assume it all went to plan." Plan sponsors assume that after they hire their plan providers that their plan providers did their job competently and it all went to plan. Well if it doesn't go to plan, the plan sponsor as a fiduciary is responsible for that. So a plan sponsor in exercising their fiduciary duty must review their plan providers on a continuing basis for cost and competence. There are too many plan sponsors who learn the hard way when they find out their plan providers haven't done their job, putting the plan sponsor in

harm's way.

Hiring a friend or relative as a plan provider

It's just natural to rely on those that we know, whether that's a friend or relative. So while there is nothing wrong with hiring your cousin to provide electrical services or use your high school classmate as your dentist, it doesn't work like that for retirement plans. Hiring a plan service provider is an exercise of the plan sponsor's fiduciary duty, so that requires a due diligent process. Simply hiring someone you're related or friendly with isn't due diligence. Due diligence requires looking at multiple, competing providers. Plan sponsors must engage in a preliminary screening process to identify a range of qualified candidates and they must document the process. The process is about reviewing potential providers and selecting those that are the right fit and just basing the decision on some prior relationship isn't due diligence. In addition, hiring certain providers such as a child or spouse may result in a prohibited transaction that puts the plan's qualified status at risk. They often say that if you can't trust family, who can your trust? Whoever said that never understood fiduciary duty or the prohibited transaction rules of qualified retirement plans. Hiring your cousin as your auto mechanic is fine, as your plan's financial advisor, not so much.

Picking the cheapest or mist expensive provider

I have an Aunt and Uncle who always feel the need to overpay and I have some relatives, who are so tight with money, they except to be buried with it. That being said, hiring a plan provider solely based on their low or high cost isn't a good idea because competency is more important. Too many low cost providers aren't very good and overpaying doesn't guarantee the provider is any good and you have a fiduciary duty to pay reasonable expenses. It's important to be focused on plan expenses, but not be obsessed with it.

Relying on a Fiduciary Warranty

When your car breaks down and it's under warranty, you know the costs of repairing the car will be borne by the manufacturer. Same with a washer and dryer. So when is a warranty not really a warranty? When it's called a fiduciary warranty! Thanks to the litigation over the past few years involving plan sponsors and breaches of fiduciary duty, several plan providers have been offering what they call "fiduciary warranties". When plan sponsors hear that term, they usually rely on it to their possible detriment because many plan sponsors assume that

a fiduciary warranty means that the plan provider assumes some fiduciary role. They don't. Some other plan sponsors assume that a fiduciary warranty means that the plan provider will indemnify the plan sponsor any time there is an allegation of a fiduciary breach. It doesn't do that either. So what does it do? Well, the plan provider warranties that the investment options selected on their platform will meet the broad range of investment requirement set forth by ERISA §404(c) for participant directed plans. That's something, isn't it? Well it's more than nothing and smaller than a bread basket. The reason is why the warranty isn't much is that the broad range of requirement of investment requirements is actually only three investments and plan sponsors rarely get sued for violating that aspect of 404(c). A fiduciary warranty is like a life insurance policy that only pays when the insured dies in a hot air balloon accident because it rarely is relied on. So why do these providers offer a warranty that offers very little fiduciary protection? Three words: marketing, marketing, and marketing.

Purchasing only an ERISA bond

People hate buying insurance and if they have to buy it, they try to buy as minimal coverage as possible. So while plan sponsors must purchase an ERISA bond, fiduciary liability insurance is optional. The problem? ERISA bonds only protect against theft of plan assets, they do not protect against any litigation against plan fiduciaries such as the plan sponsor and the individual trustee (which may involve personal liability). So instead of being covered for litigation costs under a fiduciary liability insurance, those who take the cheap route will pay these expenses out of pocket. Fiduciary liability insurance premiums are quite reasonable and will certainly save some headaches if you get sued for breach of fiduciary duty.

Not hiring an ERISA attorney

I know the knock against attorneys, they charge too much (present company excluded). While attorneys do cost money, retirement plans are legal entities governed by legal documents and laws that can create legal consequences. While most plan sponsors only use an ERISA attorney when things go wrong, consider hiring an independent ERISA attorney for an occasional plan review of what I call a plan tune-up. An ERISA attorney is like a dentist, an occasional checkup avoids drilling later. To avoid legal bill sticker shock, consider hiring an ERISA attorney who charges on a flat fee (which is the bulk of my practice).

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