Things That Won't Help A Retirement Plan Sponsor Limit Their Liability

By Ary Rosenbaum, Esq.

When I was a teenager, we were told that eating oat bran would lower cholesterol and it didn't. We're told that cracking our knuckles will cause arthritis and it doesn't. We're told that going outside when it's cold with wet hair will get us sick and that's not true. When it comes to retirement plans, plan sponsors think that there are certain services or products will limit their liability and it turns out not to be true. This article is about things out there in the retirement plan world that will not limit the liability of plan sponsors.

An ERISA Bond

All retirement plans that are subject to ERISA are required to have a bond. The bond is to protect assets from theft by a plan fiduciary. The bond should not be mistaken for fiduciary liability insurance that can offer some protection to plan fiduciaries when sued by a plan participant. While an ERISA bond is legally required, fiduciary liability insurance is not. Thanks to the litigious society this country has become, every ERISA plan should have fiduciary liability coverage.

A corporate trustee

Many retirement plan sponsors utilize the services of a trust company to serve as plan trustee. The corporate trustee typically serves in a non-discretionary role which means that the trustee will act at the direction of the plan sponsor. A corporate trustee will do almost nothing in regards to limiting fiduciary liability. Corporate trustees are typically hired when no individual from the plan sponsors wants to serve or if the plan requires an audit (because audit costs are lower when a corporate trustee is serving because the plan can get a limited scope audit). Corporate trustees may sign plan distribution checks, remit withholding on plan distributions, and certify trust statements. They do nothing else that would help a plan sponsor limit their liability in the day to day running of a retirement plan.

Using plan providers

Using third parties to serve as retirement plan providers is going to be necessary to run a retirement plan successfully. The problem is that despite using third parties to provider the expert work necessary for the continued qualification of the plan, the plan sponsor is still on the hook for liability. That's because the plan sponsor is a plan fiduciary and one of the responsibilities is to hire competent plan providers. Even hiring plan providers that will assume almost all of the liability that the plan sponsor has in administration (by hiring an ERISA §3(16) administrator) or plan investments (by hiring a financial advisor as an ERISA §3(38) fiduciary) won't totally absolve the plan sponsor of liability. That's because the plan sponsor still has the responsibility of hiring plan providers and the liability that goes with it. So hiring bad plan providers is still an issue even if those plan providers assumed the bulk of the liability in their role as plan fiduciaries. I have run into too many situations where plan sponsors have paid through the nose because they hired a bad TPA or financial advisor or ERISA attorney who steered them wrong. The plan sponsor will complain that it was the plan provider's fault, but the fact is the fault goes with the plan sponsors. Sure a plan sponsor can pursue claims of negligence and/or breach of contracts, but it's little solace when they are paying government penalties and/or litigation costs for the mistakes made by their plan provider.

An investment policy statement that isn't used

An investment policy statement (IPS) is a document that sets forth the selection and replacement of investment options under the Plan. Despite what many plan providers including an ERISA attorney think, it's not legally required. However, it's highly

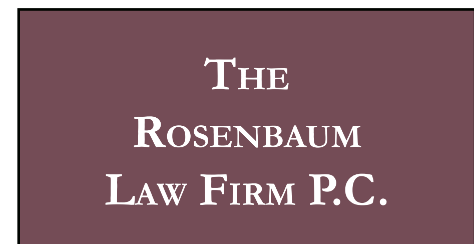
recommended. Having a blueprint on how and why a plan sponsor selected an investment is a great weapon in limiting liability because it offers a rational basis as to why the plan sponsor selected or replaced plan investments. While the point of an IPS is supposed to limit a plan sponsor's liability, it has to be a "living" document that is actually utilized. A plan that has an IPS that isn't being used is worse than a plan that does not have an IPS at all. An IPS that isn't being used is evidence that the plan sponsor was negligent in selecting and replacing plan investments because they didn't follow the blueprint. Every plan should have an IPS and actually use it.

Participant direction of investments without helping the participants

Daily valued 401(k) plans where participants directed their own investments were pushed by mutual fund companies as a way of getting more assets under management and with promises that plan sponsors would limit their liability. ERISA §404(c) shields plan sponsors from liability when participants direct their own investments. The only problem is that the liability protection isn't absolute. The liability protection is a sliding scale, not all or nothing. The liability protection is essentially in proportion to the information given to plan participants in selecting their own investments. So if a plan sponsor gives plan participants no investment education, they are going to get very little liability protection. A plan sponsor will also get little liability if all they do is hand out deferral election forms and Morningstar profiles. At the very least, plan sponsors need to provide investment education to their plan participants, which is general information on investment principles. Plan sponsors could also have a provider give investment advice that is specific to the investment of the plan and the retirement plan needs of the participant. The §404(c) protection also is tied to the discussion of the IPS because a fund lineup that is not consistently reviewed and updated or does not meet the broad range requirement of investments will help a plan sponsor lose liability protection even if they give plan participants enough information to make investment decisions.

Most fiduciary warranties

Many bundled providers (mostly insurance companies) offer plan sponsors a fiduciary warranty and the problem is that most plan sponsors assume it means something when it contractually shows that it's not worth much. First off, fiduciary warranties do not make the plan provider offering it a fiduciary unless they specifically assume that role contractually. Also, it will only help the plan sponsor in limited situations, usually that the provider will indemnify the plan sponsor if they get sued under the broad range requirement under ERISA §404(c). The problem is that plan sponsors get sued for a wide variety of reasons and plan sponsors rarely get sued for the broad range of investment requirement because any advisor who has a securities license will satisfy that requirement for their plan sponsor clients. Like insurance, warranty coverage is dictated by its terms and most providers offering them provide little or no protection to the plan sponsor that holds one of them. As a good friend of mine always says: if insurance company providers are in business of insuring risk, what does it say about these warranties if they give them away for free? He has a point. While there may be companies that have warranties with teeth, the only way a plan sponsor can determine whether this will reduce their liability headache is if the terms of the warranty are read by an ERISA attorney (cough, cough).



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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