A Call For A New Standard For Financial Advisors

By Ary Rosenbaum, Esq.

Over the last 10 years, there has certainly been a revolution among 401(k) financial advisors about the need and concern of good fiduciary practices for plan sponsors. The days of 401(k) financial advisors never showing up to meet the plan fiduciaries and collecting a quarterly fee are over. Advisors have to help a plan sponsor develop a fiduciary process in effectively managing their plan and that goes a long way in minimizing their plan sponsor's liability. However, in the scheme of things, it isn't enough. There is something more that's out there and this article will introduce to you a standard that is a higher standard. If you decide to try to meet that higher standard, I think you can augment your services as a plan advisor and let you stand up among the crowd of other financial advisors.

When Kosher isn't Kosher enough

With a name like Ary Rosenbaum, you know I'm not Greek. So let me talk about when good standards are no longer good standards because people want better. Kosher meat is Kosher because the animal is Kosher as stated in the Torah and it's been ritually slaughtered. Yet, almost no Orthodox Jews will eat Hebrew National Hot Dogs. Why? There is a higher standard of kosher meat out there called Glatt Kosher. It's been a development for over 30 years now, but Glatt Kosher is considered a higher standard because some animals that may have lesions on their lungs may be kosher, but not Glatt Kosher. It's a higher standard of kosher for Orthodox Jews to trust and they won't eat just regular kosher meat these days. I feel the same way of the fiduciary standard that advisors have been touting for the last 10 years. While it's a great standard for advisors to help a plan sponsor effectively manage the fiduciary standard, I think that there is a higher standard out there that advisors should strive for.

The current standard only looks at the hood

When I take my car in for its annual inspection, my mechanic Ralph doesn't just look under the hood. Ralph looks at all aspects of the car because what might need service for a car isn't just under the hood. If you just look under the hood, you're not seeing everything. A car has brakes, tires, shocks, and a whole host of other moving parts that can be defective and aren't under the hood. Yet financial advisors who hold themselves out to be fiduciaries just seem to care about the fiduciary process of the plan and it's only one big component of the fiduciary process. Most advisors focus on the development of an investment policy statement (IPS) and the selection and replacement of investment options. Most advisors are also concerned about plan expenses as well. An IPS, the selection of plan investments, and plan costs are just some of the issues that a plan sponsor needs to tackle to decrease their liability exposure as plan fiduciaries. Almost all small to medium-sized plans are too small to get sued in a single participant lawsuit or a class action. There are so many other ways where a plan sponsor can be liable as plan fiduciaries, yet most advisors are focused on parts of the plan that will yield the less liability. While an IPS is necessary, it's not legally required. It's a piece or a few pieces of paper that set forth the process of selecting and replacing plan investments. An IPS is just a blueprint and it will do nothing in alleviating a plan sponsor's liability in many aspects of running the plan. An IPS and picking out funds is a necessary function of a financial advisor, but it does nothing to help a plan sponsor when the Form 5500 hasn't been filed on time.

Advisors need to stop being focused on product

It's 2018 and there are certain advisors who still don't understand their role as plan fiduciaries. As a financial advisor to a 401(k) plan serving in a fiduciary capacity, the advisor is offering a fiduciary service. That service is supposed to minimize a plan sponsor's exposure as a fiduciary. A fiduciary has the highest duty of care, so a plan sponsor needs all the help they can get. Yet there are many advisors out there that are still focused on investment products. An index fund or the best performing actively managed mutual fund doesn't help a plan sponsor properly run their plan. I remember when Fidelity Magellan was the best fund out there and I assure you that a similar well-performing fund like that today, does absolutely nothing to help a plan sponsor properly run their plan especially when plan participants direct their own investments and plan sponsors can be protected from liability for participant losses. So why just being focused on the product? Advisors that focus too much on fund selection don't really understand their role and I still think most advisors out there don't properly

handle one major component of a daily valued 401(k) plans fiduciary process.

Helping Participants and a Results-Based Outcome

When Judge Elihu Smails meets up with Ty Webb in the locker room in Caddyshack, he can't believe that Ty doesn't keep score. So the Judge asks how Ty measures himself against other golfers and Ty says he measures by height. How can advisors properly show a measuring tool that compares themselves with other plan advisors? They can start by showing the results within one component of the fiduciary process that most advisors neglect: improving plan participant outcome. Showing how the funds an advisor picks are less expensive and better rated is all fine and dandy, but it doesn't really help a plan sponsor out when participants direct their own investment and ERISA doesn't require plan sponsors to guarantee a participants' rate of return. ERISA §404(c) is supposed to protect plan sponsors from liability, so talking about a plan's fund lineup or focusing on the plan's rate of return is just one measuring stick. An advisor should focus on improving a participant's outcome by increasing plan participation and providing enough guidance to them so that they can make an informed investment decision. I'm an ERISA §3(16) administrator for a large school on Long Island and I came onboard when a new advisor was selected. Over time, the advisor had relied on statistics that show that he improved the participants' outcomes under the plan. By showing the increase in plan participation; an increase in the salary deferral rate: a decrease of plan assets in the default investments; and an overall increase in participant satisfaction, the advisor can show the plan sponsor metrics that show that they're doing their job.

Offering bumper to bumper protection

Going back to the car example, it's time for advisors to stop just checking under the hood and offer a bumper-to-bumper protection level of service to plan sponsors. What does bumper-to-bumper protection? Offering a service that helps plan sponsors manage all aspects of the plan which would include vetting the other plan providers, reviewing the work of other plan providers, educating plan participants, and getting other plan providers such as an ERISA attorney when the situation warrants it. I understand that advisors will balk at the extra work, but most advisors are doing that already. Most plan advisors aren't just financial advisors, they are like an ombudsman, Rabbi and Priest wrapped together. Since they are already in position as being the closest contact that a plan sponsor has, it's important for advisors to capitalize and show the plan sponsors what work they're doing in helping the plan sponsor manage all aspects of the plan. Advisors need to stop thinking they're just advisors and start thinking abut the role they serve: plan consultants.

Focusing on the TPA

It's so amazing how many financial advisors are so energetic with the fiduciary process of the plan, but they neglect the part of the plan that causes the most liability headaches for most small and medium-sized 401(k) plans: the administration part. Perhaps many advisors think they are the star attraction and don't want to focus on plan administration, but the fact is that the selection of a third party administrator (TPA) is usually the difference between a plan sponsor having administration headaches and needless penalties and not. I don't understand how an advisor can be so concerned with the 401(k) business, but refer clients to inferior TPAs that don't have the expertise in properly help plan sponsor administer their plan. While plan costs and the selection of plan investments are great, most issues that pop up in an Internal Revenue Service (IRS) and Department of Labor (DOL) deal with plan administration. Advisors need to realize that the selection of a TPA is extremely important for them to survive as the financial advisor for the plan especially if they made the referral for that TPA. Advisors need to understand that cost for a TPA is the least important factor, what matters most is finding the right TPA for the plan sponsor. Outside of a 401(k) plan that might offer safe harbor contributions, I don't think it's wise for advisors to refer plan sponsors to the two largest payroll providers who dabble in plan administration as their TPA. Advisors need to involve TPAs who are adept at compliance testing and are creative in plan design that help plan sponsors to maximize the use of employer contributions that will provide retirement and tax savings to plan participants. Just checking under the hood of a 401(k) plan by looking at the fiduciary process neglects the administrative problems that many 401(k) plans may face. Part of this increase bumper-to-bumper service would include a review of the administration of the plan and the effectiveness of the TPA in minimizing the liability and administration headaches of the plan sponsor. Advisors need to consider a TPA an integral part of their process as plan consultants, rather than just being concerned at finding a TPA at the right price.

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