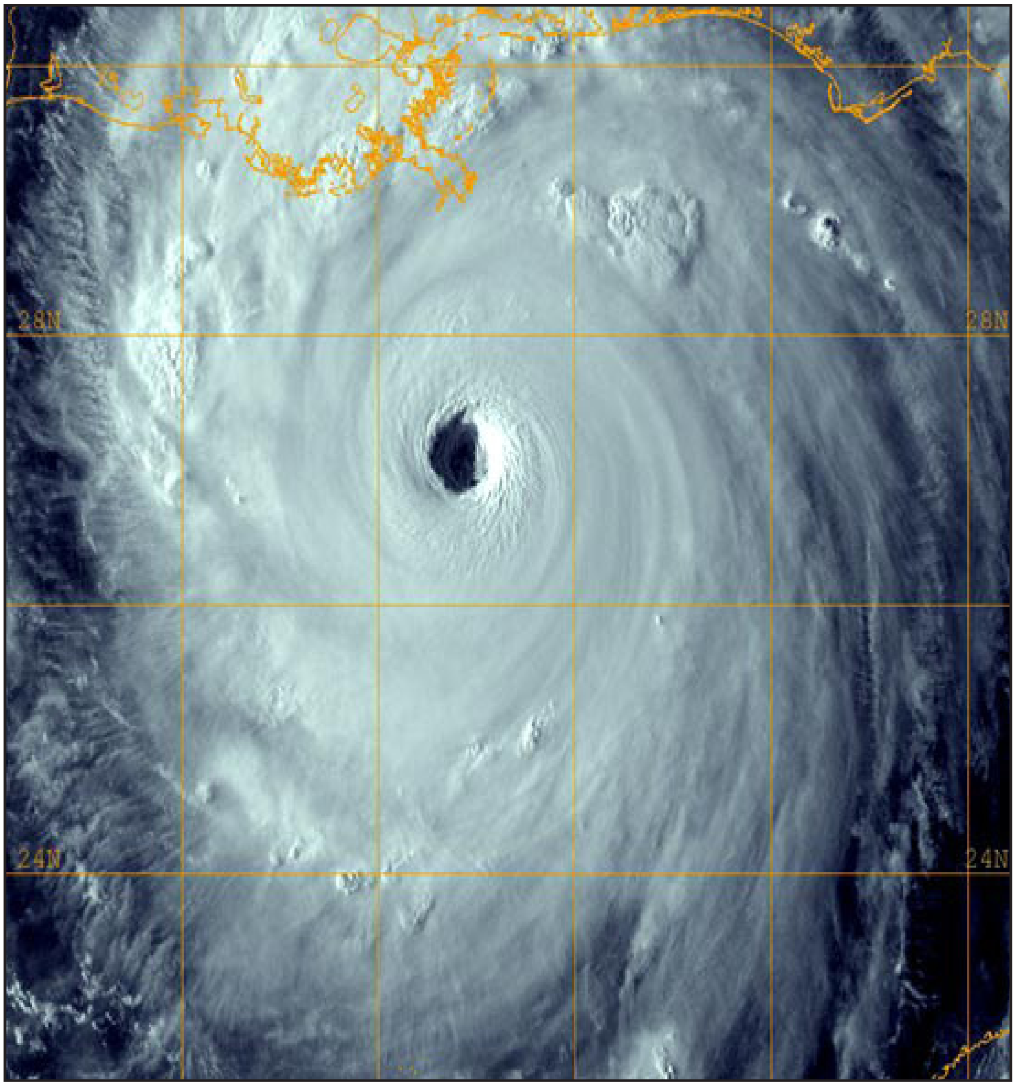
The 401(k) Storm: Are Your Prepared?

By Ary Rosenbaum, Esq.

When severe weather approaches your area, the local news educates residents on what they need to weather the storm. This information usually includes a checklist to ensure that you won't forget important items when the storm hits.

In the retirement plan world, change is afoot. With the latest bear market and concerns that 401(k) plans don't effectively save for retirement and are burdened with high fees and poor investment choices; the government has made significant changes to the way these plans operate. As a retirement plan sponsor, are you prepared for the impending storm of change? To limit your liability as a plan sponsor and to make your 401(k) plan more effective, please consider this checklist and have the answers for the questions handy.

#1 What type of plan do you have and what is its features?: I have a client who had no idea as to the nature of their defined benefit plan, as well as its structure. They were unaware that employees received different rates of employer contributions and they were



unaware that their plan was no longer efficient since the company doubled in size since the plan's inception. It is paramount as plan sponsor that you understand your plan's features, namely required contributions, eligibility and vesting requirements, as well as the company serving as the third party administration firm (TPA).

#2 Are you properly bonded and insured?: All qualified retirement plans are required by the Department of Labor to procure an ERISA bond which protects the plan assets from theft. I know of one retirement plan sponsor that missed the change to minimize their losses with Bernie Madoff because they didn't purchase the required bond. All plans should also get a fiduciary liability policy, which is not the same as an ERISA bond, because it protects fiduciaries (plan sponsor and/or trustee(s)) from personal liability in case of a lawsuit by a plan participant.

#3 Who is your financial advisor?: I have found many retirement plans that I call orphan plans because they either do not have a financial advisor or a financial advisor that they have not seen in years. In addition to knowing who your financial advisor is, it is also important to determine what fiduciary capacity they have. While current law exempts brokers from serving as a fiduciary, many registered investment advisors try to shy away from a role as a co-fiduciary

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through disclaimers in their contracts with plan sponsors. You should know who your financial advisor is, whether they are an advisor or broker, and their fiduciary role, if any.

#4 Do you have an investment policy statement and what is the education given to employees?: In recent years, the Department of Labor through plan audits have been requesting investment policy statement for the Plan under review. An investment policy statement sets the criteria for selecting suitable investments for the plan, whether the investments are participant or trustee directed. I have found that most retirement plans don’t have an investment policy statement and for those who do, many don’t have their financial advisor review their plan investments to determine whether they still meet the requirements for investments set out by the investment policy statement. If the plan is participant directed (as most 401(k) plans are these days), employees need education on plan investments in order to properly insulate the employer from liability under ERISA Section 404(c). Handing out Morningstar profiles to plan participants isn’t enough, semi-annual participant education meetings are necessary in order to properly protect employers from potential liability in a down market.

#5 Do you know the cost of your plan’s administration?: The most single misconception in the 401(k) world is that some employers believe that they pay nothing for administration. Everyone plan sponsor pays for administration in one form or another. While plan sponsors don’t have to use the cheapest TPA or plan advisor, a plan sponsor must determine whether they are getting a good value for the price they are paying. That is why it is important that the plan sponsor understand the full cost of their administration and determine on an annual basis whether those costs are reasonable by comparing what the rest of the 401(k) market is charging for these types of services. While 401(k) plans are riddled with hidden costs, many plan sponsors have been appearing as defendants in many 401(k) fee litigation cases brought by plan participants.

These 5 basic questions need 5 basic answers, especially in these changing times because I believe that any new laws concerning retirement plans may hasten the exit of many TPAs and financial advisors from the market either voluntarily or involuntarily. I also advise you to seek the advice of an independent ERISA attorney and an independent financial advisor, who have no ties to your TPA.

While sponsoring a retirement plan is a great responsibility, just being aware of your plan and its features will go a long way in limiting liability.

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