10 Liability Pitfalls That Retirement Plan Sponsors Should Avoid

By Ary Rosenbaum, Esq.

Being a retirement plan fiduciary such as a plan sponsor or a plan trustee is like being a homeowner. Homeowners see their homes as a serious financial accomplishment and an important investment. Homeowners are unaware of the hidden liability pitfalls that homeownership entails, like lawsuits for those injured on their property or the liability to trespassers who are injured because of an attractive nuisance like a swimming pool. The same can be said of a plan sponsor or a plan trustee that is unaware of the hidden liability in their roles as plan sponsors. Retirement plan sponsors have important responsibilities and are subject to standards of conduct because they act on behalf of participants in a retirement plan and their beneficiaries. These responsibilities include: acting solely in the interest of plan participants and with the exclusive purpose of providing benefits to them; carrying out their duties prudently; following the plan documents; diversifying plan investments; and paying only reasonable plan expenses. While these duties seem pretty straightforward, there are certain instances where a plan sponsor is unaware that their action or inaction puts them at risk to liability from either plan participants or governmental agencies such as the Department of Labor (DOL) and the Internal Revenue Service (IRS). For plan trustees, that liability may be personal liability. This article details pitfalls that plan sponsors are usually unaware of, that exposes them to potential fiduciary liability.

10. The ERISA bond does not protect plan sponsors from liability.

The DOL requires retirement plan sponsors to procure a bond equal to at least 10% of the amount of funds in the Plan, subject to a minimum bond of $1,000 and a maximum bond of $500,000 per plan ($1 million if the plan holds employer securities). An ERISA bond specifically insures a plan against losses due to fraud or dishonesty on the part of persons (including, but not limited to, plan fiduciaries) who handle plan funds. It does not protect plan fiduciaries from a breach of fiduciary liability. Fiduciary liability insurance can protect plan fiduciaries from such liability and should be purchased. I once represented a statewide union that had its $1 million in legal fees (albeit with a $100,000 deductible) paid by their fiduciary liability carrier after "winning" a class action lawsuit brought against them by plan participants. Without such a policy in place, my client would have had to cough up the extra $900,000 in legal fees from their own pocket.

9. The use of a corporate trustee does not protect the plan sponsor from liability.

Many plan sponsors use a corporate trustee for their retirement plan because the owners of the plan sponsor may not want to serve as trustees (exposing them to potential personal liability) or because the use of a corporate trustee allows a plan that is required to have an audit for their Form 5500 filing to have a limited scope audit (which is much less than a full scope audit). A corporate trustee does not assume the liability of the plan sponsor as plan fiduciary. A corporate trustee will pay out participants and file the required tax withholding forms. They do not hire retirement plan providers, monitor costs, review plan documents, and ensure proper plan administration. Therefore, plan sponsors are still on the hook.

8. If plan sponsors are not retirement plan experts, they should hire some.

The duty to act prudently is one of a plan fiduciary's central responsibilities under ERISA. It actually requires the plan sponsors to have expertise in a variety of areas, such as investments. Lacking that expertise, the sponsors need to hire providers with that professional knowledge to carry out the investment and recordkeeping functions. I have seen too many plan sponsors operate their plans without a financial advisor, without someone with the financial background to pick plan investments and educate participants. All retirement plan providers need to have some retirement plan experience, so plan sponsors should make sure all their retirement plan providers are retirement plan experts.

7. The hiring of plan fiduciaries must be selected through a process.

When it comes to hiring a financial advisor or a TPA, the plan sponsors need to have a process. They need to document how and why they selected a plan provider because hiring a retirement plan provider is a fiduciary function. Simply having the plan sponsors pick a financial advisor because he is related to someone who owns the plan sponsor or works for the plan sponsor isn't enough. Plan sponsors need to review the experience of the plan providers they are interested in hiring, as well as the quality of their services.

6. Plan sponsors need to keep good records.

While plan sponsors hire retirement plan providers to help them manage their fiduciary responsibility, plan sponsors need to keep all plan records as well as document all decisions they make on their own or in conjunction with one of their providers. Retirement plans are legal entities with legal documents that have legal consequences. So plan sponsors should always have copies of all plan documents, amendments, valuation reports, government filings, asset statements, trustee meeting minutes, and investment making decisions. TPAs, financial advisors, and ERISA attorneys may have some plan records, but a plan fiduciary is required to have all the plan's records because it's their responsibility.

5. Avoid the one stop shop; plan sponsors should hire at least one retirement plan provider who is independent.

Too many plan sponsors select a plan provider that serves all functions when it comes to a retirement plan. This provider is the TPA, financial advisor, and provides all the legal documents. Having one retirement plan provider to serve all those functions is a terrible idea because there is a lack of checks and balances if none of the plan providers are independent of each other. Having at least one retirement plan provider independent from another allows for each provider to check up on the other to make sure that the other is also doing their job. I have found too many plan sponsors who have suffered financial harm because they put all their "eggs" with one retirement plan provider because since the provider was wearing all the hats, there was no one to tell the plan sponsors that the provider wasn't doing their job.

4. Plan sponsors need to know the cost of their plan's administration.

Retirement plan sponsors need to know the cost of their plan's administration. They need to know how much they are being charged by their retirement plan providers and this is often difficult when retirement plan administration has fees that are often hidden from plan sponsors. While retirement plan fee disclosure is soon to be implemented by the DOL where plan sponsors will be disclosed the fees being charged by their plan providers, sponsors need to know the fees they are being charged now because plan sponsors that are unaware of the fees being charged are often sued by plan participants. Excessive fee lawsuits have been a great boon to the business of ERISA litigators.

3. Plan sponsors need to annually review the cost and services of their plan providers, as well as their Plan.

Plan sponsors need to annually review their plan providers for their cost and the services they provide. It's not enough for plan sponsors to know the costs being charged by their plan providers, they need to determine whether these costs are reasonable for the services provided. They can only do that by reviewing what competing service providers in the marketplace charge for the services they provide. In addition, plan sponsors should monitor their plan providers in the work they do. There are too many financial advisors who don't do the bulk of their jobs, such as working with the plan sponsors on an investment policy statement or educate participants. If they can't determine whether plan providers are doing their job, an independent retirement plan consultant or ERISA attorney could be hired for that task. Plan sponsors should also annually review their plan to see if the plan's provisions still fit their needs.

2. Plan sponsors are responsible for the errors and malfeasance by the retirement plan providers they selected.

The buck stops with the retirement plan sponsor. So plan sponsors are still legally responsible for the retirement plan providers they hire. So if a financial advisor that is hired is the second coming of Bernie Madoff or the TPA doesn't make the required filings, plan sponsors are still liable for them. I represented an 80 year old woman being sued by the DOL because the TPA she hired didn't provide her with valuation reports for 28 years and didn't provide the necessary distribution forms for her so that the DOL thinks she stole money or improperly borrowed from the plan. Despite her pleas that this was not her fault, as a plan fiduciary she was at fault. Hiring a retirement plan provider in and of itself is a fiduciary function. Hiring a bad retirement plan provider is a breach of that function and duty.

1. Just because a plan is participant directed, plan sponsors may still be on the hook.

The biggest major misconception that plan sponsors may have is that if their plan offers participants the right to choose their investments, then they're exempt from liability under ERISA §404(c). Plans that do not have an investment policy statement or consistently monitor plan investments or offer investment education to plan participants have often found themselves as defendants in a lawsuit by plan participants for breach of fiduciary liability.

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