Why Plan Sponsors Should Care About Their Retirement Plans

By Ary Rosenbaum, Esq.

I hear the complaints all the time from retirement plan financial advisors and third party administration (TPA) firms on how they were meeting with a plan sponsor who they knew was either paying excessive fees on their plan administration or not protecting themselves from fiduciary liability in selecting plan investments and who seemed apathetic about these serious plan issues. Plan sponsors need to understand the great responsibility they have as plan sponsors and why they need to care about their role. Overpaying for plan administration isn't the same as overpaying for a box of cereal and selecting plan investments isn't the same as selecting office furniture. With great power as a plan fiduciary comes great responsibility. Plan sponsors should also not forget why they implemented a retirement plan and what benefits that are derived from them. If run properly, a retirement plan is a great benefit. If not run properly, a retirement plan becomes a liability risk for plan sponsors.

Retirement Plans are an employee benefit

Plan sponsors often forget that retirement plans are an employee benefit. Like health insurance, a retirement plan is a benefit provided by employers to their employees. Employee benefits are used as a recruitment and employee retention tool. So it's often surprising that plan sponsors forget that a retirement plan can be used as an employee recruitment and retention tool. Retirement benefits are a benefit that any potential employee would consider in whether they should accept a job offer from a potential employer. Offering a retirement plan with an employer contribution or other attractive features such as a minimal waiting period to become a participant or an attractive investment lineup can help recruit and retain employees. Poorly constructed retirement plans with either minimal benefits or high fees don't do a good job of improving morale at the workplace. I worked at a firm with a 401(k) plan offering a fully vested 5% employer profit sharing contribution and only a three month waiting period. I also worked at another firm where their 401(k) plan had a 3% profit sharing contribution and a 7 year vesting schedule (when it was allowed) and a one year wait to become a participant. Which in my mind was the better place to work? The one with the better retirement benefits. Retirement plan sponsors don't have to afford large employer contributions; they should just understand that retirement plans are an employee benefit. Therefore, they should do their best to consistently review their plans and decide whether they need a "tune-up" to rev up the plan's "engine."

If Owner-Employees are Plan Participants, it's their retirement benefits too

If the plan sponsors are also owner-employees and are participants in their retirement plan, they also have skin in the game. That means that if their retirement plan offers poor investments, an inefficient plan design, no participant education, and excessive fees, their retirement benefits have the same fate as the benefits of their employees. In addition if the retirement plan is failing discrimination testing, especially a 401(k) plan failing the actual deferral percentage test, this may limit the owners from saving in their retirement plan. Inefficient plan design may also leave money on the table because it was designed in a fashion that owner-employees could not maximize employer contributions to them and maximize tax deductions for their corporate entity. Plan sponsors should consistently review their plan design for efficiency and to try to maximize their retirement benefit. This may mean the addition of a new comparability/cross tested allocation for employer contributions in a 401(k) or profit sharing plan, or the addition of another retirement plan such as a non-qualified plan, defined benefit or cash balance plan. Plan sponsors need to understand the value of a good TPA, because a good TPA has the background to develop a plan design that meets the plan sponsor's needs and the retirement needs of their owner-employees and highly compensated employees. What better way for plan sponsors to have incentive to improve their retirement plans than self interest in their own retirement benefit as owner-employees?

Plan sponsors are fiduciaries and are ultimately responsible for their retirement plan

In addition to plan trustees, the plan sponsor is a fiduciary of the retirement plan they sponsor. People may joke that they found the cure for apathy that plan sponsors have for their retirement plans, but no one cares enough to let plan sponsors know what it is. However, the cure for apathy that plan sponsors have is their fiduciary duty and the potential liability that goes with it. The fiduciary duty for a plan sponsor contains these responsibilities: acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them; carrying out their duties prudently; following the plan documents (unless inconsistent with ERISA); diversifying plan investments; and paying only reasonable plan expenses. This seems like a large list, but that is the responsibility of being a plan sponsor. So what can a plan sponsor do? They can take their responsibility seriously and develop good practices that will significantly decrease the likelihood of a breach of fiduciary duty. This includes an annual review of the plan terms, the plan investment selection process, education to participants, and a determination the reasonableness of plan fees by comparing what is available in the marketplace. Critics will state that the likelihood of a small to medium sized retirement plan is slim to none, but the litigation practice for ERISA attorneys who sues plan providers and sponsors is constantly evolving and while ERISA litigators exhaust the list of larger plans, one could assume that smaller plans may eventually be the next target because like bounty hunters, ERISA litigations firms need to eat too. So while the risk for being sued for a breach of fiduciary duty may be small, why should plan sponsors take that risk when simple measures like working with a top notch TPA, financial advisor, and ERISA attorney can minimize the risk, no matter how small it may be?

Even if participants direct the election of their investments, plan sponsors may still be legally responsible

With a participant directed retirement plan where participants direct their own retirement investments, there is a big misnomer on the fiduciary responsibility of plan sponsors. While ERISA Section 404(c) limits the liability of plan sponsors that have in the gain or loss of a participant's account if a participant directs their own investments, it's not a suicide pact. Plan sponsors have a fiduciary responsibility under ERISA §404(c) and if they fail in that responsibility, they will be held liable even if a participant chooses their investment. That responsibility includes the development of an investment policy statement (IPS) with a financial advisor which serves as a blueprint as to why the investment options under the plan were selected, when they should be removed, and when they should be maintained. The investment options should be reviewed at least annually to determine whether the investment options still meet the criteria set forth in the IPS and education should be given to participants on the investment options offered. After 12 years in the retirement plan industry, I am no longer surprised by the amount of retirement plans that don't have a financial advisor assisting them, don't have an IPS, don't consistently review the investment options in their plan, or don't offer education to participants. Plan sponsors should make sure that if they don't have a financial advisor, they should get one and if they do have one, make sure that they actually assist in the fiduciary process to take advantage of the limited liability offered under ERISA §404(c).

The road to plan sponsor hell is paved with good intentions

When a plan sponsor implemented a retirement plan, they did it with the best of intentions. Very few plan sponsors have bad intentions in sponsoring a retirement plan and those are the plan sponsors that act as if the plan assets are their own piggy bank. For the plan sponsors with good intentions, there are so many who have breached their fiduciary duty without any intent or malice, but just based on the trust in others that have been betrayed. If a plan sponsor selects a plan provider such as a financial advisor, TPA, auditor, or ERISA attorney that has committed negligence or fraud, the plan sponsor still is responsible because the role of the fiduciary requires them to be responsible because one of the duties of a fiduciary is to select those rogue plan providers. For my two clients who lost fortunes in Bernie Madoff, they were responsible for making plan participants whole. Plan sponsors who have been sued for paying excessive fees to their TPA are often sued because they had no knowledge of the fees that they were paying because the TPA had no legal responsibility to inform them of all of the direct and indirect compensation the TPA received. A California utility was found to have breached their fiduciary duty of prudence because their 401(k) plan had retail class shares in the plan even though less expensive, institutional share classes were available. So the plan sponsor lost their case because plan participants paid retail and not wholesale for the mutual funds offered in the plan. I have a client being sued by the Department of Labor (DOL). My client was taken advantage of by a TPA who for 28 years, never did valuation reports and gave such poor advice that the DOL thinks that they stole money from their plan. While my client protests their innocence, their responsibility as a plan fiduciary makes them ultimately responsible for this TPA's gross negligence. Life is not fair and neither is the life of a plan sponsor who was betrayed by poor advice, negligence, or fraud.

Cynical retirement plan professionals will insist that this article is an exercise in futility. I disagree because for years, the retirement plan industry has evolved and so has the sophistication of a plan sponsor. Plan sponsors never asked about plan expenses and thanks to impending fee disclosure regulations, they have been asking about fees. Plan sponsors have also been more concerned on plan investments and education. This is the result of the explosion of information available on the Internet and certainly the media reports of plan sponsors being sued for excessive fees or breach of the investment selection process, Plan sponsors need to be aware why they should care about the retirement plans and hopefully this article can serve as one answer as to why they should.

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