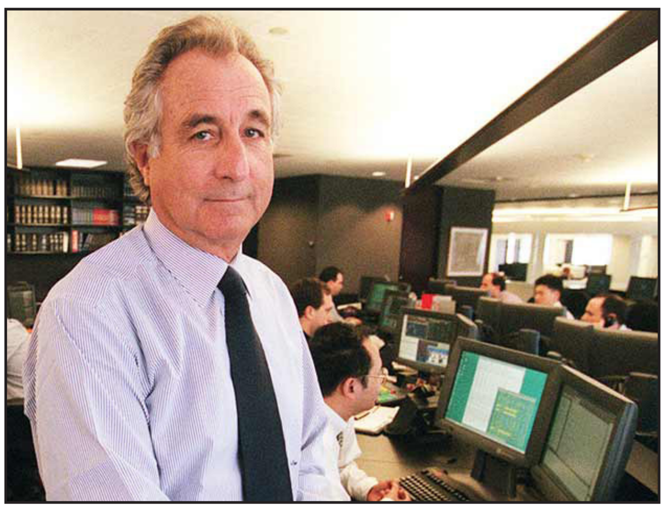
How Plan Sponsors Should Select and Review their Retirement Plan Providers

By Ary Rosenbaum, Esq.

Bernie Madoff was one of the most successful financial advisors out there. His reputation was impeccable, his advancement in technology led to the development of the NASDAQ. His brokerage firm was one of the largest market makers on Wall Street, yet Madoff still had an asset advisory business that was growing even the fact he never truly publicized it. Madoff's trading strategy was almost as secretive as the Colonel's secret recipe and the formula for Coca Cola. Although Madoff's asset advisory business ultimately grew into a multi-billion-dollar operation, none of the major derivatives firms traded with him because they didn't think his numbers were real. None of the major Wall Street firms invested with him either, and several high-ranking executives at those firms suspected he wasn't legitimate. Others also contended it was inconceivable that the growing volume of Madoff's accounts could be competently and legitimately serviced by his documented accounting/auditing firm, a three-person firm with only one active accountant. In addition, Madoff maintained custody of the advisory business' assets. Despite all the suggestions that his rate of return was impossible based on the market and based on the amount of trades he claimed to have made, Madoff could claim that the Securities and Exchange Commission had no issues with him and he could turn down money from potential clients who asked too many questions. People still tried to invest with him because Madoff made a name for himself on the country club scene, as well as the tight knit Jewish community. People invested based on his perceived reputation and the exclusiveness of his club of investors such as Mets owner Fred Wilpon and Nobel Peace Prize winner Ellie Wiesel. Of course, Madoff's fund was a giant ponzi scheme and thousands of investors were out billions of dollars. Some investors ended up destitute, some committed suicide, some charitable organization investors (including two of my former clients) had to close down their doors. There were even retirement plan sponsors who invested with Madoff who had their entire plan account balances wiped out (I have two current clients with that calamity).



While individuals should always be wary of rogue service providers, retirement plan sponsors should be even more wary. While negligent or criminal retirement plan service providers are to blame for their transgressions, plan sponsors as plan fiduciaries are ultimately responsible for the work of their service providers. As plan fiduciaries, plan sponsors and the trustees for their plan have fiduciary responsibility. These responsibilities include: 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 the law); diversifying plan investments; and paying only reasonable plan expenses.

The duty to act prudently is one of a plan fiduciary's chief responsibilities under ERISA. It requires expertise in a variety of areas. Since fiduciaries will not likely have that expertise, a plan sponsor will want to hire someone with that professional knowledge to help carry out the investment function and other functions such as a third party administrator (TPA) to handle the administration and recordkeeping. The duty of prudence focuses on the process for making fiduciary decisions. Therefore, it is wise for the plan sponsor to document decisions and the basis for those decisions. So in hiring any plan service provider, a plan sponsor needs to survey a number of potential providers. By doing so, a plan sponsor can document the process and make a meaningful comparison and selection. The documentation is an important defense if there are any issues as to why a service provider was picked. The problem is that most plan sponsors have never done that, they typically hire a service provider based on a simple recommendation. Some plan sponsors hire a service provider because that service provider is related to the bank that they have a line of credit with or a service provider that is related to one of the plan sponsor's decision makers or employees. Plan sponsors need a process to select a service provider, so just making that selection based on one recommendation opens the plan sponsor to a lot of liability if the referral is negligent and the service provider is as well. In addition, nepotism isn't a reason why a service provider should be selected, there are more considerations to consider and wetting the "beak" of a family member where the retirement savings of plan participants is paramount can be a distracting headache if things go south. People often say that it is who you know and not what you know. When it comes to selecting plan providers, they should be selected on what they know.

Hiring a service provider in and of itself is a fiduciary function. Even hiring an ERISA §3(38) fiduciary who assumes all the fiduciary decision making is a fiduciary function and can subject the plan sponsor to liability if the fiduciary is negligent. So when considering prospective service providers, plan sponsors should provide each of them with complete and identical information about the plan and what services they are looking for so that you can make a meaningful comparison.

Some criteria a plan sponsor needs to consider when selecting a service provider include:

- Information about the service provider itself: financial condition and experience with retirement plans of similar size and complexity because the plan provider should be the right fit for the plan;
- Information about the quality of the firm's services: the background and experience of professionals who will be handling the plan's account; any recent litigation or government action that has been taken against the firm; and
- A description of business practices: how plan assets will be invested or how plan records will be kept; and whether the firm has fiduciary liability insurance and/or errors & omissions liability coverage.

The plan provider selection process should be documented, which would include the materials provided by the competing service providers, as well as legitimate criteria why a certain provider was selected. By documenting their decision, plan sponsors can reduce their liability in selecting plan providers.

Even after the plan sponsor selects plan providers, they should consistently review them to determine whether they actually do their work. A plan sponsor should establish and follow a formal review process at reasonable intervals (every 1-3 years) to decide if it wants to continue using the current service providers or look for replacements. When monitoring service providers, actions to ensure they are performing the agreed-upon services include:

- Reviewing the service providers' performance;
- Reading any reports they provide;
- Checking actual fees charged;
- Asking about policies and practices ; and
- Following up on participant complaints.

The problem with fiduciary responsibility, is that not only is a fiduciary concerned with their job, they also are responsible for the jobs they delegated to third parties, and may be liable for things that they may be unaware of and that were done without their malice to plan participants. I had a client being sued by the Department of Labor (DOL) because of the poor work done by the TPA. For almost 30 years, the TPA failed to complete any valuation reports or distribution packages to the owner-employees making the DOL think that my client had stolen money from plan participants, which was not the case. Plan sponsors need to ensure that their plan providers are doing their jobs in a competent fashion, so a plan review such as my Retirement Plan Tune-Up for $750 is a cost effective approach to evaluate the competency of a plan sponsor's providers. This review can effectively root out issues that are associated with poor plan providers, that are ultimately the responsibility of the plan sponsor because the buck stops with the plan sponsor.

In addition, the final implementation of fee disclosure rules will add greater needs to a plan sponsor reviewing their plan providers. With the final implementation of these disclosures in 2012, plan sponsors will finally receive a full breakdown of the direct and indirect costs charged by their plan providers. Since plan expenses will no longer be hidden, plan sponsors will now have no excuse why they can't determine whether the plan expenses that are being charged to the plan are reasonable or not. Plan sponsors will now be under greater pressure to review their plan costs and shop their plan around to other service providers to determine whether the fees being charges are reasonable in light of the services that the plan is receiving. Fee disclosure is all about information and the more information that plan sponsors receive will reduce the amount of excuse why plan sponsors don't adopt criteria in reviewing their service providers. Whether a plan sponsor uses my Retirement Plan Tune-Up or another type of review, plan sponsors need an objective review of their plan providers to determine their competency and whether their costs are reasonable.

Whether it's selecting a plan provider or relying on their work, a plan sponsor is still ultimately on the hook for the work of third parties. In order to successfully reduce that fiduciary liability risk, plan sponsors should adopt processes that they can use to select and review their plan providers because ultimately, they are on the hook as plan fiduciaries.

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