When A 401(k) Plan Sponsor May Have To Fire Their Advisor

By Ary Rosenbaum, Esq.

For most 401(k) plan sponsors, it's the financial advisor that serves as their ombudsman. They're usually the provider that the plan sponsor relies on most to provide referrals to other providers such as third-party administrators (TPAs) and to help out when things aren't going so well. One big part of when things aren't going so well is when the financial advisor isn't doing their job competently and doing a disservice to the plan sponsor. This article is about situations where the plan sponsor may have to fire their financial advisor.

The advisor doesn't disclose their fee

Thanks to the Department of Labor (DOL) fee disclosure regulations, any advisor that charges a 40(k) plan more than $1,000 needs to provide the plan sponsor with the required disclosures of their fees. If the plan sponsor fails to get the disclosure and does nothing, they run the risk that transactions with the advisor are considered prohibited transactions. The problem with having these transactions considered as a prohibited transaction, there'd be financial penalties set by the DOL and as a plan fiduciary, the plan sponsor will be responsible for paying the bill. If an advisor can't do something as basic and as required as providing a fee disclosure, there is no reason to keep such an unprofessional provider.

The advisor's fee is unreasonable

401(k) plan sponsors have a fiduciary duty to pay reasonable plan expenses. As I will state constantly, it doesn't mean they have to pick the cheapest provider. It means that they just have to make sure that the fees they pay are reasonable based on the services provided. A 401(k) plan sponsor can pay more if the level of service is higher. The only way a plan sponsor can determine if the fee their advisor is charging is reasonable is by shopping the plan around to other advisor or by benchmarking fees through a service. How unreasonable is unreasonable? A perfect example is when I was asked by a medical practice about their 401(k) plan. My review indicated that the broker on the plan was making 60 basis points on a $14 million plan, which was an $84,000 commission. The broker never showed up to meet the client, never reviewed plan investments with and never educated plan participants. I advised the client that the fee was unreasonable even if the broker was doing his job. The broker was fired and an ERISA §3(38) fiduciary was hired who assumed the liability that goes with the fiduciary process of the plan. The 3(38) fiduciary would do all the work for only 25 basis points. Fee disclosure regulations in 2012 was a great thing for plan sponsors because it finally allowed them to have fee transparency, which is important when they have the fiduciary duty to pay reasonable plan expenses. Too many plan sponsors ignore their fee disclosures and that is an absolute mistake especially when DOL agents on the audit are asking for fee disclosures and asking plan sponsors their process for selecting plan providers. If an advisor's fee is unreasonable, it's usually a sign that they need to be replaced.

They don't regularly communicate with the plan sponsor

When I speak at plan sponsor and plan provider events, I usually joke about something I call "the milk carton financial advisor". That's the advisor who has been missing so long from the plan's sponsors' offices, they should be put on a milk carton. Seriously, thee are a lot of 401(k) financial advisors out there that collect their quarterly fee and never communicate with the client. It's my opinion that any 401(k) plan needs to meet with their financial advisor at least semi-annually to review the plan, the investment lineup, and conduct participant enrollment/education meetings. That advisor in the previous

paragraph was collecting an $84,000 a year in commission from a plan that he wasn't providing any service to. It is clearly a breach of duty for the plan sponsor to pay an advisor a fee for doing no work because if they're not communicating with the plan sponsor over the status of the 401(k) plan. A plan sponsor can't afford to pay an advisor for doing nothing in more ways than one. A plan sponsor needs an advisor that does their job by holding regular meetings with the plan trustee that reviews the plan, the investment lineup, and conduct employee education meetings.

They ignore plan participants

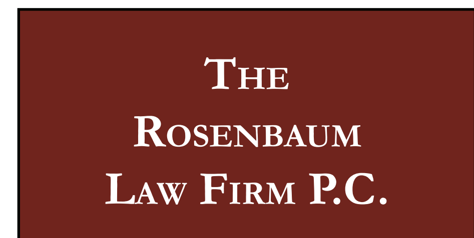
There are too many financial advisors that fail to understand their role as the advisor to a 401(k) plan. They think they're superstars because they pick the greatest mutual fund lineups for 401(k) plans. Picking the great lineups don't mean anything if they neglect plan participants. Advisors can't neglect participants especially when the 401(k) plan is a participant-directed plan. A participant directed 401(k) plan is an ERISA §404(c) plan and there are too many advisors who think that a participant-directed plan automatically eliminates the plan sponsor's liability from the losses incurred by a participant. Plan sponsors don't get automatic liability protection from a participant's losses. ERISA §404(c) requires a process which includes a prudent section of plan investments based on set criteria and providing enough information to plan participants so they make informed investment choices. The human resources director at my old law firm will hate that I'm mentioning it again, but when the firm wasn't providing any type of investment education and they hadn't updated the fund lineup for 10 years, they would get zero liability protection if a participant sued them. Lucky for them, I was there and advised them that what they were doing put them in harm's way and they hired an advisor that would help the plan sponsor manage their judiciary process.

Giving awful plan provider referrals

I often say that a big reason that financial advisors get fired is for making bad plan provider referrals. A plan sponsor often relies on their financial advisor for referrals because they assume that the providers should know a thing or two about which providers do a decent job of providing plan service to 401(k) sponsors. Sometimes a financial advisor can make a referral to a third party administrator (TPA) or ERISA attorney that doesn't go well. It's happened to me when I made a bad referral to an ERISA auditor and it was embarrassing. However, there are some referrals that are so bad, it puts the plan sponsor at risk and begs the question of whether the advisor knows what they're talking about. Most of the time, referrals are based on first-hand knowledge by the advisor that the referred plan provider can do a competent job. Sometimes, the referral isn't based on first-hand knowledge of whether the referred provider can do a competent job. Sometimes the referral is simply paid through work referred back to the advisor such as a payroll provider TPA. Mistakes happen all the time and the referral was a mistake, yet there are referrals that are so bad that the plan sponsor might question the competence of the advisor who made it.

The advisor made a mistake and won't admit it

Even the best advisors make mistakes because they're human just like you and me. How many mistakes an advisor makes is important and very good advisors don't make many. The problem with mistakes is how the advisor deals with them. A good advisor will admit when they've made a mistake and will help the plan sponsor fix the error, usually on their own dime. However, as an ERISA attorney, I've seen way too many time where the advisor makes the mistake and refuses to admit it, even going to great lengths to avoid fixing it including firing the plan sponsor as their client. For example, I had a 401(k) plan sponsor client that was advised by their advisor to switch providers, neglecting to tell them that there would be a 3% surrender charge on one of the investments in the plan. While the advisor neglected that little detail, the advisor at the time, seemed willing to make the plan whole until he found out that it would cost about $40,000 to make the participants whole. At that point, the advisor stopped returning emails and fired the plan sponsor client to cover his tracks in this mess. A lot of times, advisors won't admit to any type of error at all even when it's certain that they were complicit in. Advisors make mistakes, some more than others. The important part is that it's not frequent and the advisor is willing to make amends for their error. If the advisor is making excuses or is enlisting in the witness protection program, it's probably a good idea to fire them.



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