As Plan Sponsor, How You Can Prepare For a 401(k) Hurricane

By Ary Rosenbaum, Esq.

Aside from a few forgettable years living in Washington D.C. for law school and a memorable year on Boston for a tax LLM degree, I have lived my entire life in the New York City area. For the first 35 years of my life, severe weather problems were limited to a blizzard or a severe rainstorm. Whether it's global warming or some other phenomenon, that's changed, as New York has become a hotbed of hurricane activity. Hurricanes Isabel and Sandy have changed the way people in my area live as many of us including yours truly have suffered enormous losses. Hurricane Sandy destroyed both my cars as well as destroying the entire downstairs of my home. When the hurricanes approached our area, the local news educated us on what we need to weather the storm. This information usually includes a checklist to ensure that we wouldn't forget important items when the storm hits. When it comes to retirement plans as a retirement plan sponsor, you have to be prepared in case of a storm of another kind that can foster litigation from aggrieved participants. This storm could be the result of another bear market or the new 401(k0fee disclosures. 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? It's amazing that employers can go through the trouble of setting u p a retirement plan without understanding how it works and what requirements are on them in terms of funding. 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 that as a plan sponsor, you have to 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 chance 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 the costs of litigation in case of a lawsuit by a plan participant. While a fiduciary liability policy is optional (unlike an ERISA bond), you are asking for trouble if you don't get one.

#3 Who is your financial advisor? I have found many retirement plans that we call orphan plans because they either do not have a financial advisor or a financial advisor that they have not seen in years. They also may have a "milk carton" advi-

sor where they need a milk carton to advertise the fact that their advisor is “missing”, or at least not bothering to visit them. In addition to knowing whom your financial advisor is, it’s also important to determine what fiduciary capacity they have. Most brokers won’t serve in any fiduciary capacity, but some will. There are registered investment advisors who can serve as a co-fiduciary, and ERISA §3(21) fiduciary (full or limited scope), or a full scope ERISA §3(38) fiduciary. The difference? A heck of a lot because that will determine how much liability and responsibility that your advisor will assume. 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 the investment policy statement for the Plan under review. An investment policy statement sets the criteria for selecting and replacing the 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 (at least) 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 biggest misconception in the 401(k) world is that a lot of employers believe that they pay nothing for administration. Every plan sponsor pays for administration in one form or another and now they have the fee disclosure from their plan provider to prove that. 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’s important that the plan sponsor to 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.

#6 Are you reviewing your plan providers? While your plan providers such as your TPA and financial advisors assume some of your administrative duties in running the plan, they do not assume all of the responsibility and liability that go with it. So even if a plan provider such as your TPA screws up, you will still be on the hook for liability. Even using an ERISA §3(38) fiduciary who will assume the investment decision making process will result in some liability to you if they are incompetent. So you need to review your providers for the quality of their service and their competence. It’s certainly recommended that you have your providers reviewed because I have seen too many plan sponsors suffer as a result

These 6 basic questions need 6 basic answers, especially in these changing times of 401(k) fee transparency and a stock market and economy in flux. 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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The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw