The "Real" Role of a 401(k) Plan Financial Advisor

By Ary Rosenbaum, Esq.

Over time, there are so many full time positions in the workforce that are as obsolete as the Atari 2600 in my garage. Many people remember the milkman or the diaper man who made deliveries or the woman who worked the luncheonette counter at the 5 and dime. My children will never know the video rental store clerk or the seltzer deliveryman. Pretty soon the 401(k) plan sponsor won't know of the financial advisor who does nothing for their plan except collecting a nice fee every quarter. This article is about what the role of a 401(k) financial advisor really is. If you are a financial advisor new to the 401(k) space or you don't know what your role as a 401(k) financial advisor is, this article is for you.

It's not about picking funds

When I see a financial advisor tout the funds that they pick for their plan sponsor clients, then I realize that this is an advisor that probably doesn't understand the true nature of being a 401(k) financial advisor. Since most 401(k) plans are participant directed, rates of return are meaningless. Since there are thousands of mutual funds out there, there are enough good funds out there that can meet the needs of any 401(k) plan lineup. Despite what plan providers who offer fiduciary warranties say, plan sponsors don't get sued for what funds are in a 401(k) plan, they get sued for a breach in the process of selecting those funds. It's theoretically possible that a plan sponsor can have the greatest fund lineup in 401(k) history, but be liable for a breach in the fiduciary process in selecting that All Star lineup. Picking investment options for a participant directed 401(k) plan is one of the least important duties that a financial advisor has in working with their plan sponsor clients.

It's all about liability protection

While asset management is such a great business (or used to be, depending on your view), it's all a small piece of your work on 401(k) plans. When you have a private client, it's all about investment management and rate of return. For 401(k) plan sponsor clients, it's all about liability protection. While many individuals direct their own investments through some of the online discount brokerage firms, plan sponsors with employees can't do it alone. While plan sponsors can probably pick a decent fund lineup for their 401(k) by reading some reports, they don't have the background and training that they need to limit their liability. The role of a competent 401(k) financial advisor is liability protection. A good advisor will understand the nuts and bolts of helping a plan sponsor manage the plan. Helping a 401(k) plan sponsor as an advisor is all about making the plan less prone from litigation and government scrutiny, it's all about liability protection. Liability protection is all about good fiduciary practices. It's helping the 401(k) plan sponsor understand their duties with the fiduciary process. Regular meetings with the fiduciaries, taking notes of these meetings, developing an Investment Policy Statement (IPS), reviewing the fund lineup against the IPS, and offering support to plan participants are the foundation for protecting a plan sponsor from allegations of a breach of fiduciary duty.

It's all education and advice these days

One of the most important aspect in being a 401(k) plan advisor is making sure plan participants have the background to make informed investment decisions. At they very least, you need to offer investment education to your client's participants. You can offer investment advice on your own (as long as you meet the new advice regulations) or you can have that duty farmed out to another party like rj20, who charge a reasonable per head charge. Offering education and/or advice will help your clients minimize their potential liability.

The different levels of liability protection

401(k) plan advisors can be brokers or registered investment advisors, which also means that they can offer different levels of protection to plan sponsors. If you're a broker, you are not a fiduciary to your plan sponsor clients unless your broker-dealer allows you to take on that role. Some brokers with large 401(k) books of business have been allowed to assume that role. Clearly, a 401(k) advisor who is a fiduciary to the plans they service is clearly assuming more liability on their own accord than someone who isn't. Being a fiduciary to a plan is a little more than assuming the liability that goes with it, it is owing a duty of care to the plan and a fiduciary duty is the highest duty in equity and law.

So as a fiduciary, everything done is for the best interests to the plan and the participants. So if you serve in a fiduciary capacity, you can't be pushing a specific investment that pays you more than other investments and you have to be careful how you gain rollover business from former plan participants. In addition to taking on a co-fiduciary role as an advisor, there are different levels of fiduciaries that seem to be the rage in the retirement plan industry. Instead of just taking on a co-fiduciary role, you can be a limited scope or full scope 3(21) fiduciary or be an ERISA 3(38) investment manager where you assume discretionary control and almost all of the liability that goes with it. While you may offer all, some, or none of these designations, you need to realize that any fiduciary liability that you are willing or unwilling to take should be specified in your contract with a plan sponsor client. Not only do you need to do that to meet the requirements of the fee disclosure regulations, you need to make sure you are not taking on more of a fiduciary role you need to take as well as stating the requisite fiduciary role you are taking on that is consistent with what you're advertising. Believe me there is nothing more humiliating than advertising yourself as an ERISA 3(38) investment manager and not taking on the role of exercising discretionary control. Check with an ERISA attorney (cough, cough) to make sure your contract promises the protection your services are willing to offer to plan sponsor clients.

You are an ombudsman

Whether you like it or not, as a 401(k) plan financial advisor, you are one of the plan sponsor's most trusted advisors. That means when things go wrong with the plan, you are going to get the call to help get it fixed. It's more problematic is what goes wrong is committed by a provider that you recommend. Well, that's a long story to be covered shortly.

Be careful whom you refer as a TPA

While you may think you are indispensible to your client, the fact is that the most important plan provider that your client can have is a third party administrator (TPA). Keep your egos checked at the door and realize that many of the trouble spots for a retirement plan is picking the wrong TPA. While plopping a plan down on a payroll provider TPA maybe a good idea, it may not be a good idea for your client. A good TPA will help you with managing your clients by streamlining plan administration and augmenting tax savings for your clients through plan design features that many no frill TPAs like payroll providers don't provide. Since it's expected that marginal income tax rates will rise over the long haul, a TPA that can help a plan sponsor save more money for their highly compensated employees through a new comparability profit sharing allocation, safe harbor contributions, and or using another pan like a cash balance plan. The no frill TPAs won't do that because it's usually above their comprehension. Their needs to be a good fit between the TPA and your client, so it's important to make sure that the fees are reasonable for the services provided. If your client needs help with plan design because they have the finances and demographics to add more employer contribution, then find the TPA who can do that because another 401(k) advisor can beat you to the punch and steal your client.

Be on top of the right share classes

Mutual fund share classes are like alphabet soup. Thanks to a case in California called Tibble, plan sponsors may be on the hook for breaching their fiduciary duty of prudence if they use retail share classes of mutual funds if institutional share classes are available for those very same mutual funds based on the plan's asset size. Now that you have enough on your plate, your added work is making sure that your clients have the right share classes based on the size of their plan. Always contact the mutual fund company or TPA or plan custodian to find out the best fit for your clients.

Having the right team

Getting a Series 7 was hard work; so you don't need to be an expert in plan administration and ERISA. That is why it's paramount to round out your team by developing strategic relationships with ERISA attorneys, TPAs, and auditors that can help you with questions that you or your client may have. This retirement plan business is all about relationships, with your client and with other providers. Networking with other providers who can help augment your practice will let you stand out in the crowd. Let's face it, and advisor who can get some free help from an ERISA attorney on a conference call is far more impressive than the advisor who can't. If you are interested in developing a strategic relationship with an ERISA attorney, I know a good one (cough, cough). There are quite a few TPAs who fit the bill as well.

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