Dumb Things Retirement Plan Sponsors Should Avoid Doing

By Ary Rosenbaum, Esq.

Whoever said that there is no such thing as a dumb question obviously wasn't in attendance at my Global History class in high school when someone asked whether it was true that if you take a picture of an Amish person, the picture doesn't come out? Seriously while there may not be dumb questions, there are dumb things that retirement plan sponsors might do and this article is a list of dumb things plan sponsors should avoid doing.

Doing nothing and asking no questions

Sgt. Schultz on Hogan's Heroes would was always look the other way when Col. Hogan and the inmates of Stalag 13 were up to their shenanigans by proclaiming: "I hear nothing, I see nothing, I know nothing!" While the Sgt. Schultz defense works well with politicians, employees, and law firm partners, it doesn't work well with plan sponsors. As plan fiduciaries, plan sponsors don't have the luxury of playing dumb. They need to be aware of what is going on with their plan and their plan providers, they essentially have to serve as a check and balance to make sure the plan is working correctly because it's their responsibility if something isn't going right. Doing a Sgt. Schultz impersonation that they know nothing won't do the plan sponsor any good because it's their job to know everything.

Hiring a relative as a plan provider

Nepotism is a part of business whether you like it or not and I discovered it when the dumb associate at the firm I was a law clerk at was the top partner's son. While it's a staple of business, it should not be a staple of being a retirement plan sponsor. While we often give work to people we know, it's not something plan sponsors should be doing because of their role as plan fiduciaries. Hiring a relative as a plan provider is a bad idea for many reasons. First off, hiring a close enough relative could be considered a prohibited transaction because the Department of Labor (DOL) might consider (right or wrong) that the plan sponsor is deriving some sort of benefit by hiring that relative as a plan provider. Secondly any hiring of a plan provider should be through a selection process with criteria on how providers should be selected and it's hard to have a legitimate process if the provider selected happens to be related to the plan sponsor or an employee of the plan sponsor. Thirdly, a plan sponsor should have the power to fire a provider for cause and it's extremely difficult to fire a relative as a plan provider if you want to remain a relative. Heck, I've been disowned for far less. If a plan sponsor wants to hire a cousin as a receptionist, it might get a nasty look from some employees. However, if a plan sponsors hires a cousin as the plan's financial advisor, the DOL and/or an aggrieved participant's attorney may take a closer look.

Doing nothing with the fee disclosures

Annually, plan providers who charge $1,000 or more in fees to the plan must provide a fee disclosure to the plan sponsor. Unlike those privacy policy statements you get from the bank, a plan sponsor shouldn't be chucking those fee disclosures in the trash. A plan sponsor has the fiduciary duty to pay reasonable plan expenses for the service provided and a plan sponsor can't determine reasonableness by chucking those fee disclosures or by putting them in the back of the drawer. How could a plan sponsor determine reasonableness? By shopping around the plan to other providers or by using a benchmarking service. It's important that a plan sponsor understands what services their plan provider provides for them because reasonableness is determined by the services provided because the fee disclosure rules don't require plan sponsors to pay the lowest plan expenses, just reasonable plan expenses.

Picking a plan provider just because of their low fee

They often say that you get what you pay for and that unfortunately happens often in the retirement plan business. Again, plan sponsors have the fiduciary responsibility to pay reasonable plan expenses. In addition, plan sponsors have a duty of prudence in selecting plan sponsors. In evaluating current and potential plan providers, plan sponsors need to be diligent because the plan sponsor will be holding the bag if a plan provider does a poor job. So plan sponsors need to do some sort of investigation to see if a plan provider is up to the task in offering competent retirement plan services. So just picking a plan provider because they are the cheapest provider out there is a disaster in the making because many times, the cheapest plan provider is an incompetent plan provider. That's not to suggest that a low cost plan provider can't do a great job, but a plan sponsor can't determine that off the bat if all they did was hire a plan provider based on price. Many plan sponsors have had a rude awakening that their cheap plan provider weren't even worth the low fees that they were paying them. Picking a plan provider just on price is a dumb gamble for any plan sponsor.

Not understanding the liability of a participant directed retirement plan

When a plan sponsor set up their retirement plan, they were likely told that allowing participants to direct their own investment in a 401(k) plan or another defined contribution plan would eliminate the plan sponsor's liability for any losses that the participant sustained. Unfortunately, almost all of that is untrue. ERISA §404(c) is supposed to limited the liability of a plan sponsors from losses sustained by a participant directing their own investments. ERISA §404(c) is supposed to limit liability as long as plan sponsors do their job. Plan providers never talk about the plan sponsor's role in providing plan participants with the investment options and background in what I call the fiduciary process. A plan sponsor needs to have a financial advisor who will work with them on developing an investment policy statement (IPS), selecting and replacing plan investments based on the IPS, and giving plan participants the opportunity to obtain enough information to make educated investment decisions. So a plan sponsor who thinks they can offer investment options that haven't been updated in 5-10 years and hand out some Morningstar profiles to their employees and limit their liability are doing something dumb and that should be avoided. If a plan sponsor can't put in a fiduciary process to limit their liability, then they need a team of competent plan providers who can help achieve that.

Not making sure the plan fits their financial condition

A retirement plan should be tailored like a suit; it should be designed and maintained to meet the financial needs of the plan sponsor. Too often, a plan sponsor starts a retirement plan when they first start the business and don't take annual looks at the plan to still see whether it still meets their financial needs. A defined benefit plan set up when the plan sponsor had three or four employees may now be too expensive if the plan sponsor has a dozen employees. A stronger balance sheet may allow plan sponsor to offer a safe harbor 401(k) that eliminates the need for many of the discrimination testing by making fully vested contribution to rank and file employees while maximizing retirement savings for the higher paid employees. On the flip side, a business in distress may require the elimination of a safe harbor 401(k) or a new comparability plan design. A retirement plan is like a car, it can't be neglected and it needs to be constantly maintained. A plan sponsor maybe wasting employer contributions or paying more in taxes by not maximizing contributions to their retirement plan just because they fail to annually review their retirement plan as it pertains to their financial health.

Not having fiduciary liability insurance

Insurance is all about insuring risk and after reading this article; you know that there is so much potential liability as a plan sponsor. Since we are such a litigious society, it is important that a plan sponsor purchase fiduciary liability insurance to protect themselves and the plan trustee from liability costs associated with running a retirement plan. It is absolutely dumb for plan sponsor not to have any type of fiduciary liability insurance.

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