Warning Signs that Your Retirement Plan Might Be In Trouble

By Ary Rosenbaum, Esq.

When it comes to your health, there are warning signs when you're about to suffer a heart attack or a stroke. If you pay attention to these warnings signs, you might avoid a serious medical emergency. While a retirement plan isn't the same as your health, there are also warning signs that your plan is in trouble. If you pay attention to these warnings signs, you might avoid costly problems with your retirement plan like compliance fees and penalties as well as potential fiduciary liability. These are some of the warnings signs that your retirement plan might be in serious trouble:

1. A plan where the third party administrator (TPA) is not fully transparent on fees, especially with respect to indirect payments they receive, such as revenue sharing payments from mutual funds.

Despite the requirements about fee disclosures, some TPAs still aren't fully transparent about their fees. Some TPAs invent fees like inflated custody charges or offer confusing jargon that makes it difficult to read those disclosures. Fee disclosures don't have to read like a legal treatise. If your TPA offers confusing disclosures, it might be a sign that the fees you are paying may not be so reasonable.

2. A company that has profit-sharing and money purchase plans that covers the same group of employees.

Many plan sponsors determined to pair plans -- a money purchase plan combined with a profit sharing plan (whether it is a 401(k) plan or not) -- because of the deductibility limits on profit-sharing plan contributions. Because the limit changed in 2002, most plan sponsors merged their money purchase plans into their profit sharing plans in order to save on administrative expenses; the need for two plans was mostly eliminated when the limit on profit-sharing contribution deductions was lifted from 15% to 25% (so as to be on par with money purchase plans).

3. A plan that has consistently failed its discrimination testing -- for salary deferrals, top heavy, match or 410(b) participation.

If a plan is consistently failing its discrimination tests, it is certainly a sign of a problem. While failed discrimination tests need to be remedied, there are many plan designs, such as a safe harbor plan 401(k), that can help avoid these types of failures and save plan sponsors some money and some headaches. There are too many plans failing discrimination tests with TPAs who did not have the foresight to suggest what type of corrective plan designs can be used.

4. An underfunded defined benefit plan.

With a falling stock market, a defined benefit plan that is underfunded in its obligations to participants at normal retirement age will become even more underfunded. Any plan that is underfunded, whether or not the plan has frozen its accrual of benefits (contributions for current service) should have s? study to determine what can be done, whether it is to freeze contributions, change its investment strategy, or engineer an exit plan to terminate the plan over a seven year period (or less).

5. A defined benefit plan for a company that has increased their workforce.

Any plan sponsor with a defined benefit plan with an expanding workforce should determine, in consultation with its TPA and accountant, whether the plan remains affordable, as an increase in employees corresponds to an increase in required contributions.

6. Any plan with no financial advisor.

Every retirement plan that has employee participants needs a financial advisor to help develop an investment policy statement, choose and replace investments, as well as offer investment education. A TPA who assists in fund menu selection and fails to assume a fiduciary role is not a financial advisor. Neither is a payroll provider who serves as a TPA with suggested fund lineups.

7. A money purchase plan that is covering non-collectively bargained employees.

Like #2, money purchase plans for non-collectively bargained employees should go the way of Betamax or bellbottoms. Unless contractually required, a money purchase plan should be converted into a profit sharing plan.

8. Any 401(k) plan that has not reviewed its contract with its insurance company provider in the last five years.

Plans should always review their contracts with a plan provider that is an insurance company. Perhaps the provider has a better program or pricing based on the plan's size or economies of scale, or perhaps a plan is better going the fully unbundled route. Only in reviewing a contract can a plan sponsor possibly know whether it might be paying too much in fees.

9. Any plan without an investment policy statement (IPS).

Any retirement plan, whether or not its investments are participant-directed, must have an IPS that dictates what criteria were used in how investment options were selected as well as when they are replaced. Outside of a plan document, it is probably the most important document that a plan sponsor needs to have to protect against fiduciary liability. A plan without an IPS is a plan inviting legal challenge.

10. Any plan that has not reviewed its choice of investments in the last year.

It is not enough that a retirement plan has an IPS. In order to manage the fiduciary process and minimize liability, the plan sponsor and trustees must review their investment options on a semi-annual or annual basis and determine whether they still meet the criteria set forth by the IPS.

11. Any plan that has not seen its financial advisor in the last year.

Having a financial advisor that is invisible and is not meeting with the fiduciaries on a consistent basis – whether quarterly, semi-annually, or even annually -- is practically the same as not having one (see #6 above).

12. A participant directed retirement plan that offers no education to plan participants.

If a plan is participant directed, plan participants should be provided with education because, under ERISA 404(c), plan participants must be provided, or have the opportunity to obtain, sufficient investment information regarding the investment options available under the plan in order to make informed investment decisions. A plan that offers no education to participants risks some liability from financially uninformed plan participants.

13. Any plan without an ERISA bond and/or fiduciary liability insurance.

Generally, every retirement plan needs an ERISA bond to protect plan assets from theft. In addition, any plan with employees as plan participants should purchase fiduciary liability insurance to protect plan sponsors and fiduciaries to protect against any liability lawsuits from plan participants.

14. A 401(k) plan with low participation or low average account balance per participant.

These may be the result of the employee population and the type of employees the plan covers. It also may be explained by something less innocuous like poor investment education or lack of enrollment meetings. Regardless, it should be reviewed.

15. Any plan that has not been updated in the last two-three years.

Whether it is a plan amendment or a review of its fees or administration, it is imperative that plans be reviewed on a 2-3 years basis, although annually is preferable, to ensure that the plan still meets the needs of the plan sponsor and that there are no glaring administrative issues such as out-of-date plan documents or record-keeping errors.

THE ROSENBAUM LAW FIRM P.C.

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