How a Plan Sponsor Can Avoid Being a Deer Caught in the Headlights

By Ary Rosenbaum, Esq.

The term "deer in the headlights" explains the mental state of a person who shows behavioral signs that remind us of a deer subjected to a car's headlights where the deer is in such panic that they show no motor reaction to avoid the car. A retirement plan sponsor acts like a deer in the headlights when the plan sponsor is paralyzed by fear when a plan participant has sued them or when their plan is under Internal Revenue Service (IRS) or Department of Labor (DOL) review. The retirement plan sponsor is paralyzed by fear because they don't know the responsibilities of being a plan sponsor or what to do, so this article will help a plan sponsor avoid being the deer in the headlights if there ends up being an issue with the plan.

Understanding the responsibility that goes with being a plan sponsor

If an employer set up a health insurance plan or some other benefit they provide, there is usually very little consequences that they may suffer if something goes wrong. Even with requirements like the Affordable Care Act, an employer can easily resolve issues that they may face most of the time. With retirement plans, plan sponsors don't get off so easy because of their role as a plan fiduciary. Being a plan fiduciary is the highest duty in law and equity because a plan sponsor is responsible for the retirement plan assets of their employees. So with greater responsibility, comes greater care. A plan sponsor can't afford to neglect their duties as a retirement plan sponsor or play the Sgt. Schultz from Hogan's Heroes by claiming: "I hear nothing, I see nothing, I know nothing!" While they can't be Sgt. Schultz, they certainly also can't be Col. Klink who was so woefully inept as the commander of Stalag 13. Plan sponsors need to understand their responsibility as a plan sponsor. Once they understand that, the rest comes easy.

Keep copies of everything

When the IRS or DOL audits a plan, the agent in charge of the audit will ask for a laundry list of documents they need for the review. Most of the time I've been involved, the plan sponsor panics because they don't have any plan records. Every retirement plan sponsors needs to keep copies of all of their plan documents from the initial implementation of the plan. The plan sponsor also needs to keep all the annual valuation reports they received from their TPA, as well as any payroll records/ employee census reports. It sounds like a lot of files, but we live in a day of scanning and pdf. copies; so storing much of this stuff electronically is a lot easier that keeping multiple file drawers like plan sponsors had to do in the past. While most plan records can be tossed after 7 years or so, all plan documents and amendments must be preserved. You never know when the IRS or the TPA may require. A few years back, I had to review the 1976 plan document for a defined benefit plan to look at its vesting schedule. As for other plan records, I still would recommend preserving all records especially since online storage of plan records is far less costly and roomier than paper records.

Use a good TPA

There are many reasons why a retirement plan is audited and most of the time; the audit is random to ensure that retirement plans voluntarily comply with the Internal Revenue Code and ERISA. While many times an audit can be as a result of a complaint by a plan participant, most of the time it's not and an audit can spot errors that have never been discovered before. Compliance testing that the plan was thought to have passed might be reviewed and then found out it failed which would require the plan sponsor to correct the errors that took place years earlier. One mistaken compliance test could lead the government auditor to review other years, which could lead to discovery of other errors in other years. The only solution to avoid these compliance errors is to hire a good TPA who rarely makes these kinds of mistakes. The problem of a plan sponsor hiring an ineffectual TPA is that any penalties that result from errors discovered on a plan audit belong to the plan sponsor and not to the TPA. A plan sponsor has the fiduciary responsibility to hire competent plan providers and they are on the hook for liability if they hire incompetent plan providers. So that's why a plan sponsor should exercise their fiduciary responsibility prudently and hire a competent TPA to alleviate the burden of being a plan sponsor because poor administration will negatively affect a plan sponsor during an audit review and subject them to pecuniary penalties. A good way for a plan sponsor to avoid being paralyzed in front of the headlights of a government auditor is to work with a competent TPA.

Having an advisor who shows up and does their job

I warn plan sponsors that they shouldn't have a financial advisor who is a "milk carton advisor" which means they have been missing so long from the offices of the plan sponsor that they should be placed on a milk carton. What plan sponsors need to realize is that their financial advisor is not just someone who shows up, picks investment options, leaves, never returns, and still collects a quarterly fee. Hiring a good financial advisor is all about limiting the plan sponsor's liability when it comes to the plan's fiduciary process. So a good financial advisor will help a plan sponsor avoid being a deer caught in the headlights by limiting the plan sponsor's liability exposure. The financial advisor does that by helping the plan sponsors implement an investment policy statement (IPS), select and replace investment options based on the IPS, and offering investment education to plan participants. To do this credible job, the financial advisor also has to meet the plan sponsors every now and then to review the plan's fiduciary process and to let the plan sponsor on the job they are currently doing. Why so serious about the role of a financial advisor? Many plan sponsors are under this mistake notion that when plan participants direct their own investments that the plan sponsor is off the hook for any losses from the participant's account under ERISA §404(c). The problem is that plan sponsors don't read ERISA §404(c) because liability is only limited if plan participants get enough information to make informed investment decisions. Handing out Morningstar profiles of mutual funds to plan participants isn't enough information; it actually has to be at the very least investment education on investing concepts. Giving investment education or advice will help plan participants in making their own investments which will help plan sponsors limit their liability under ERISA §404(c). In addition, the DOL has been requesting plan sponsors for the IPS and education materials. Somehow, I think if a plan sponsor doesn't have an IPS or participant education materials, it will be a strike against them.

Having fiduciary liability insurance and ERISA bond

The reason to have insurance is to insure risk against loss. There are two easy methods to insure that risk and they should not be confused with each other. An ERISA

bond is a bond that is required for all ERISA plans to protect plan assets from theft by a plan fiduciary. So the client I had who invested all their pension money with Bernie Madoff was out of luck because they didn't have an ERISA bond. Fiduciary liability insurance on the other hand is not required, but I suggest every retirement plan sponsor purchase coverage. Fiduciary liability insurance is used to insure against potential liability for plan fiduciaries such as the plan sponsor and the trustees of the plan. Even if a retirement plan sponsor wins any litigation brought forth by a plan participant, legal fees are high. If a plan sponsor loses litigation, the bills are even higher for damages. That is why a retirement plan sponsor should purchase coverage to protect themselves and the individuals of the company they selected as plan trustee because fiduciary liability can involve personal liability and no plan trustee wants to be forced into personal bankruptcy for any alleged mistakes made by them as plan trustee. A plan sponsor should contact their insurance broker for coverage. It should also be noted that if a retirement plan sponsor answers that they do not have an ERISA bond on their Form 5500, it's a good target for a "random" DOL audit.

Reviewing the plan annually

People hate the dentist, but people make regular dental checkups to avoid a greater harm down the line. Retirement plan sponsors should have the same approach. Some surprises are nice, but the surprise that a plan has many compliance issues when discovered on audit isn't one of them. That's why a plan sponsor should have their plan reviewed annually by an outside retirement plan consultant or an ERISA attorney (cough, cough). If a retirement plan has an audit requirement for their 5500, it should be noted that a plan review does not duplicate a plan audit that the plan's auditor prepares because an audit is about the safety of plan assets and less concerned with many compliance issues such as excessive plan expenses. A retirement plan review can root out issues before a government auditor, your next plan provider, or a participant's legal counsel finds it first. Fee disclosure regulations implemented a few years back also makes a plan review almost a necessity because plan sponsors have a fiduciary responsibility to pay reasonable plan expenses and the only way to determine whether they are reasonable or not is through a review. Plan sponsor will be surprised how reasonable a review could be in terms of price (cough, cough)

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