How a 401(k) Financial Advisor Can Limit Their Liability

By Ary Rosenbaum, Esq.

There is the old saying that the cobbler's children have no shoes. I know that firsthand when my mother threatened to call an electrician because my father the electrician didn't have time to do some electrical work in our house. The phrase about the cobbler's children is less about a cobbler and more about how certain 'professionals' in any given area are so busy with work for their clients that they neglect using their professional skills to help themselves or those closest to them. The same can be some of retirement plan financial advisors who worry so much about reducing their plan sponsors' fiduciary risk that they often neglect their own risk as the plan's financial advisor. So this article is about how as a retirement plan financial advisor, you can limit your liability.

Know your role (fiduciary role, that is)

As a financial advisor, you can serve many different fiduciary roles and that will determine your liability. If you are a broker, you're probably not serving in any fiduciary role. That doesn't mean you have no liability, it just means less liability than a fiduciary because a fiduciary duty is the highest duty of care in equity or law. A limited scope ERISA §3(21) fiduciary isn't supposed to have the same discretionary control than an ERISA §3(38) fiduciary has since that control brings with it more liability. While the thought is that it should be easy for you to identify your fiduciary role as a financial advisor, you should review your contractual terms with the clients and your processes. Sometimes you are performing a higher fiduciary role than what you claim in your contract or vice versa. The danger is that if you take on more of a fiduciary role than what you contractually promised then you are taking on more potential liability than you are actually charging for. If you are taking less fiduciary control than what you promised in your contract, the danger is that a competing financial advisor may catch on and cause you to lose that client.

Make sure you have the right liability insurance

When I am contacted by financial advisors seeking my guidance in becoming an ERISA §3(38) fiduciary because of my flat fee approach in developing client service agreements (shameless plug here), the first thing I tell this financial advisor is to check whether their liability insurance will cover the expanded role and liability that comes with being an ERISA §3(38) fiduciary. Often times, these advisors find out that their current liability coverage wouldn't cover that role so they speak to their insurance broker to make sure that it will be covered going forward. There is nothing worse to find out you have the wrong coverage when you're getting sued. So it makes sense to talk to counsel and your insurance carrier to see you have the right coverage for the work you are doing.

Draft an Investment Policy Statement (IPS) for the client

The most important part of being a retirement plan financial advisor is not picking mutual funds, it's about minimizing your client's fiduciary responsibility as a plan sponsor. The first line of defense is helping them develop an IPS. The IPS is designed to guide the plan sponsor as it decides, with you (if you are a §3(38) fiduciary, on investment options to include in the plan, and to evaluate the performance of those investments over time. The IPS should also be shared with plan participants to help them understand the reasoning behind the inclusion, and exclusion, of investment options in the plan—for example, to provide asset diversification, reduce risk and keep fees low. Spelling out these reasons in the IPS can help plan participants select appropriate investments for their own individual retirement portfolio from the plan's investment menu. If Plan participants do well with their investments, it's less likely they will sue.

Document everything

There is no better recorder and preserver of history than my wife. My wife takes notes of every conversation and keeps track of every correspondence. This does her well in her role as an attorney, but it's helped us quite a bit in our many disagreements with home contractors. So to limit your potential liability, it's important to document everything. Take notes and minutes for meetings with your clients, detail what was discussed. Document any decisions made regarding plan investments and the IPS. If you offer investment education to plan participants, always have a sign in sheet. Keep copies of investment education materials that were handed out at the meeting and any correspondence that advertised that meeting. Making sure that you record your work is something I call "papering the process" because your role is to help the plan sponsor with the fiduciary process. So if you can document that you did your job in a reasonable manner, it's less likely any court would find breaching your duty to the plan sponsor. Good recordkeeping can go along way in confirming you did a more than reasonable job as the plan's financial advisor.

Offer investment education and/or advice to plan participants

If the retirement plan's investments are participant directed, the only way to gain liability protection for losses incurred by plan participants under a self directed pla under ERISA §404(c) is to make sure plan participants enough information to make investment decisions. With apologies to my former human resources director, handing out Morningstar profiles of the investments under the plan isn't enough information. As a financial advisor, you need to make sure that plan participants have enough information to make informed investment decisions. At a bare minimum, you need to offer investment education, which is about educating plan participants on basic investment principles such as asset classes, diversification, and dollar cost averaging. As a plan provider, you can offer investment advice, which is recommending what a participant should be investing in. Offering investment advice isn't so simple, you have to abide by the Department of Labor's investment advice regulations which would require a demonstration that you make a level fee for the investments you offer (requiring an audit) or a demonstration that the advice is unbiased and based on a computer model. If the cost of compliance is prohibitive, I recommend the hiring of a firm that would offer advice to plan participants such as rj20.com for a nominal per head charge. Informed plan participants have a better rate of return than participants who get no information. Which participant do you think is more likely to sue?

Partner up with other advisors

Just because someone else is an advisor, it doesn't mean they are your competition especially if they aren't working in your area of the country. If your practice doesn't offer a §3(38) service or another high level of fiduciary service, it makes sense to partner up with someone who does. Not only does it spread the liability to another investment advisor, you could also rely on that advisor because they likely have more experience than you do. James Holland from Millenium Investment & Retirement Advisors is someone you should consider reaching out to you if you are fairly knew to the game. I also recommend joining Chuck Hammond's 401(k) Study Group which is a great group of advisors that you could learn from and lean on for advice. If you join, I hear they give you a free copy of my e-book (cheap plug here).

Have counsel review your process

People who think they know everything don't. There is nothing wrong with asking someone from the outside on whether you are doing something right or wrong. Heck, I do it too just because I want to make sure I'm not going crazy overthinking something. From time to time, it makes sense to touch base with you're your securities regulation counsel and your ERISA counsel to make sure that the processes you have out in place are still in compliance for your practice and for your clients. Laws change, regulations change, so it's imperative that anything coming from your office is still in compliance. While counsel costs money, the cost of being out of compliance can be costlier. I didn't start a national ERISA practice for my advisory clients because I wanted to gouge them by the hour. My fees are reasonable and flat, so my clients have cost certainty for their compliance needs. As it's been documented by other providers in other avenues, always feel free to drop me a line at no cost unless you hire me.

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