# Hidden Dangers Of A Retirement Plan That A Plan Sponsor Needs To Prevent

By Ary Rosenbaum, Esq.

One of the major cornerstones of the American dream is the purchase of a home. Owning a home can be tax advantageous as our government has encouraged home ownership through mortgage and real estate tax deductions. While owning a home has its financial advantages, it does meet those advantages with huge costs. Homes need to be constantly maintained and upgraded over time. A bathroom or kitchen from 40 years ago needs to be updated, as would a boiler with 10 years on its clock. In addition, a home can be damaged through a natural disaster such as an earthquake, a flood, or a hurricane. While most of the pitfalls of home ownership are easily apparent, there are some hidden dangers within the home that can actually make its occupants get ill without any warning or clue. It may be radon in the basement, toxic mold under the carpet, or dangerous gasses emanating from poorly manufactured drywall.

Retirement plans are similar to homes. They also are a cornerstone of the American dream. Retirements plans are generally implemented to save money for employees for their retirement. Like homes, our government encourages retirement savings by offering tax deductions to employers that sponsor and contribute to them while also offering tax deferrals on a participant's retirement savings until distribution at retirement. The tax benefit comes at a huge cost because the retirement plan must go through important compliance testing so that the plan doesn't discriminate in favor of highly compensated employees. The problem with retirement plans is that most of the dangers to the plan sponsor as a plan fiduciary are hidden and if the plan sponsor doesn't surround themselves with the right retirement plan providers, they run the risk of breaching their fiduciary duty. Unfortunately for plan sponsors, they don't often realize their duties as a plan fiduciary until after they breached them, So this article will try to illustrate the hidden dangers of retirement plan sponsorship and how they can be prevented.

**Plan Administrative Errors**

Retirement plans that qualify under Section 401 of the Internal Revenue Code require highly technical compliance and reporting to maintain its tax qualification. That is why a retirement plan needs the services of a third party administrator (TPA) to conduct the required discrimination testing, reconciliation of plan assets, and the preparation of its annual tax reporting form (Form 5500). The retention of a TPA is one of the plan sponsor's most important fiduciary duties because plan sponsors need quality plan administration to preserve its tax qualification and administrative errors threaten it.

The problem is that most plan sponsors don't know if they have picked the wrong TPA until it's too late. The main difference between a good TPA and a bad TPA is competency of administrative services and recordkeeping. The good TPA will administer the plan with very few operational errors and will correct the rare error that they have created and discovered on their own. The bad TPA will have many errors and substantive errors. Most of these bad TPAs won't correct these errors because they are so utterly incompetent that they are unaware of them. The problem with uncorrected administrative errors such as using the wrong definition of plan compensation or calculating the discrimination tests incorrectly is that they are usually only discovered on a plan audit or the conversion of the plan to a TPA. Of course, only retirement plans with 100 or more participants require a plan audit, so smaller plans only have the conversion process to weed out these errors. Well what happens if the plan doesn't change TPAs? Well I had a plan sponsor client who used a TPA for 28 years who never produced a valuation report or proper distribution forms for the benefits of the owners of the plan sponsor. Since the plan records are not existent and the distribution checks are, my client was being sued for $4 million because the Department of Labor (DOL) assumed that my client embezzled funds that were for the exclusive benefit of their employees. My client had no records to dissuade the government. While my client insisted that this problem was the result of the TPA's

incompetence, my client was still responsible as a plan sponsor and a fiduciary.

While a plan sponsor has the ability to sue a TPA for negligence, the plan sponsor is still held responsible for these errors because the buck stops with the plan fiduciary and hiring incompetent plan providers such as a TPA is a breach of fiduciary duty. I have seen too many plan sponsors pay penalties and excise taxes for errors that are only discovered by a review from the Internal Revenue Service and/or the DOL. How can plan sponsors avoid such a lurking danger? Plan sponsors should have their plan's administration and recordkeeping reviewed by an independent retirement plan consultant or ERISA attorney. While plan sponsors may think this review is cost prohibitive (I do have a plan review called the Retirement Plan Tune-Up for only $750), its may be cost effective to avoid a greater harm in penalties or in severe cases, possible plan disqualification.

**Plan Investments**

One of the main parts of a retirement plan is the investment of plan assets with the hopes of capital appreciation since the hope is to grow retirement assets at a rate higher than inflation. The problem is that plan sponsors are unaware of the dangers involved in the selection of plan investments, especially with plans that have their investments directed by participants under ERISA Section 404(c) which is supposed to protect plan sponsors and fiduciaries from liability.

First off, regardless of whom directs the investments of the plan assets (participants or the trustees), a plan must have an investment policy statement (IPS). An IPS dictates what criteria the plan sponsor (with the help of their financial advisor) uses in selecting and replacing the investment options offered under the plan. The IPS is the most important document a plan sponsor needs besides a plan document and summary plan description in trying to avoid liability for the breach of fiduciary duty and it must be followed.

In addition, there has been a major misconception when it comes to participant directed plans under ERISA Section 404(c). To get the liability protection under Section 404(c), Plan sponsors must: prudently select and monitor plan investment options, provide appropriate investment choices and information enabling participants to make educated decisions, and document that all participants receive such information. So preparing and following an IPS isn't enough, plan sponsors need to offer meaningful education to allow participants to make educated investment decisions. That education should be offered through the plan's advisor or through an on-line provider such as rj20.com or Smart401k.com. Regardless of who provides it, it must be done.

**Plan Costs**

One of the major fiduciary responsibilities that the plan sponsor has as a fiduciary is to only pay reasonable administrative expenses. Most of the litigation regarding retirement plans these days have been involving plan costs. Not only are plan sponsors being sued for high administrative expenses, they are also being sued by for using more expensive share classes of mutual funds when less expensive institutional share classes of the very same funds are available.

The problem that plan sponsors had with plan expenses was that there was no required disclosure by plan providers on how much they were receiving in compensation for providing services to plan sponsors. So while plan sponsors got vague fee explanations from their providers, they were on the hook to make sure they were reasonable. That will change in April 2012 when the DOL's regulation on fee disclosure will become effective. Plan sponsors will get a disclosure of all direct and indirect fees that their plan provider will collect. While many plan sponsors will take that form and put in the drawer, this is a fiduciary liability risk. In order to comply with the regulations, the expenses that the plan will pay must be reasonable and the only way it will be considered reasonable is if the plan sponsor compares those fees to what is offered in the industry on an annual or bi-annual basis. A plan sponsor will only know if they have a good deal on fees is if they see what other plan providers are offering. Plan sponsors should consult with an independent retirement plan consultant or ERISA attorney to review their plan expenses as well as whether the mutual fund share classes and investment platform that their plan uses still is applicable to a plan of their size. Too many retirement plans pay too much in plan expenses because they never bothered to review their fees and many of them only know they are paying too much when they get sued by an aggrieved plan participant.

Like a radon test or a mold test, plan sponsors need to take a proactive approach in reviewing their plan. They need to surround themselves with retirement plan experts to determine whether their plan's administration is being done correctly, the investment process is being managed correctly, and whether the fees are reasonable. Neglecting your retirement plan is like neglecting your home; not doing the required maintenance will make it fall apart and cause damage on its own.

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**The Rosenbaum Law Firm P.C.**
**734 Franklin Avenue, Suite 302**
**Garden City, New York 11530**
**(516) 594-1557**

**http://www.therosenbaumlawfirm.com**
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