The Paradigm Shift in Retirement Plan Consulting

By Charles Auerbach, CFP®

Employers who currently sponsor defined contribution 401(k) and profit sharing plans need to take note. The world is changing. Since its inception in 1981, 401(k) plans have evolved from employer directed accounts housed in one large pool of investments to individual employee directed accounts with varied and complex investment options. This has placed a great deal of administrative and record-keeping burden on the employer and his related service providers. Similarly, the burden of selecting and managing investments has now shifted to the participant employees who most often are ill prepared or advised to handle those decisions.

Enter now the Department of Labor (DOL). As one of the two primary regulators of qualified plans, the other being the I.R.S., the DOL is most responsible for monitoring compliance under the Employment Retirement Income Security Act (ERISA) of 1974 governing the rules employers need to follow in operating their retirement plan. One of those rules is that the employer who creates or sponsors the plan is a fiduciary by law. This means that said person or persons must operate the plan in a prudent and reasonable manner exclusively for the benefit of his employee participants and their beneficiaries. This can be a cumbersome and daunting task and is not well understood by most plan sponsors.

The important takeaway here is that the employer is going to be held personally liable for any fines, penalties, damages or possibly even the disqualification of the plan and the subsequent tax liabilities that may attach to the plan as a result of errors, omissions, or regulatory action taken against the plan. The key word here is personal liability. And there is no practical manner to insure or eliminate that liability. Take heart, however. There are ways that a prudent employer plan sponsor can significantly mitigate that liability. How? By delegating his responsibilities to prudent experts (service providers) and ensuring those service providers are managing those responsibilities appropriately.

Now here is the rub. All service providers, whether they be Third Party Administrators, Auditors, Record-keepers, Custodians, Investment providers, Investment managers and Investment Advisors all provide service contracts which will be executed between themselves and the employer. The devil is in the details of those contracts as to what degree of mitigation of liability they will provide to the employer. Most provider contracts in place today do a good job of elaborating in great detail all of the services that will be rendered to the employer and the plan and the compensation that will be paid for those services. However, in many instances those contracts will equally detail the terms and conditions under which the service provider will not be liable. When carefully scrutinized, the employer will discover that, in the end, the buck stops with him in the event that a liability occurs. The exception to this can only occur if the service provider declares in writing that they are willing to act as a Fiduciary. This has to be a declarative statement. By doing so, the service provider is acknowledging their legal responsibilities to serve the plan and a willingness to accept financial responsibility along with the employer in the event that a liability occurs resulting from the services they provided.

Again, the key word here is Fiduciary. As previously stated, the employer is always a Fiduciary. Will his service providers also declare themselves to be a Fiduciary? Those employers who delegate Fiduciary responsibilities to service providers who will also act in a Fiduciary capacity will have done as much as prudently possible to meet their obligations according to the DOL. From a practical perspective they will also have strategic partners who are willing to acknowledge and accept the burden of sharing any possible liability to the plan should it occur.

So the primary paradigm shift in retirement plan consulting that is occurring today is the evolution of service providers who are now readily willing and able to declare themselves as Fiduciaries. The definition of Fiduciary is covered in a few different sections of ERISA Code. The specific sections that would be of importance to an employer would be Section 3(21), 3(38), and 3(16). The first two relate to investment advisors and the latter to Record-keepers, Third Party Administrators, etc. The secondary shift or trend that is occurring is that services providers, especially those that are rendering investment advice, are moving towards providing those services on a fee for service basis as opposed to the existing commission compensation arrangement. The payment of commissions for investment services has been, and still is, the prevailing arrangement in the smaller plan market place. This is a market that has been traditionally served by insurance agents and securities brokerage registered representatives. In order for someone to provide investment advice to a retirement plan and charge a fee for services, that individual must be registered as an Investment Adviser Representative (IAR) with a State or SEC Registered Investment Adviser (RIA) firm.

According to ERISA Regulation 408(b)2 made effective July 1, 2012, the employer is now responsible for the receipt of a detailed annual breakdown of all fees being charged to the plan by all service providers. It is also a requirement that the employer review those fees to determine if they are "reasonable" in light of the services being rendered. The DOL does not specifically define the term "reasonable fees". This is subjective criteria and will vary based upon the facts and circumstances of each case. However, employers can go a long way towards meeting this responsibility by conducting an independent benchmarking of their plan fees. This is done by comparing your plan fees with a universe of fees being charged to plans of similar size (participants and assets), and in similar industry categories. Fortunately, there are now available objective consulting services which have access to data bases that possess all of this information and can easily do this comparative analysis. It is recommended that this benchmarking be done on an annual basis and that appropriate documentation of its findings be retained in the employer files along with any action taken in response to the findings.

When it comes to sponsoring a qualified retirement 401(k) plan, employers need to be mindful of all of their fiduciary responsibilities. Many of these responsibilities can and should be delegated to prudent third party experts. It is now "best practices" to ask if those prudent experts are willing to declare in writing that they will act in a Fiduciary capacity. If not, perhaps it may well be in your best interest to review your current service provider agreements and determine their contractual obligations to your plan.

WEALTH STRATEGIES GROUP