The 401(k) Fiduciary Nightmare

A guide to managing fiduciary risk in retirement plans.

Red Paper

Many business owners don't even know that they are the fiduciary for their 401(k) retirement plan. For most business owners, the 401(k) plan is more of a nuisance than a benefit. The business owner would rather be focusing on running their business and not bogged down on the ERISA requirements and restrictions posed on their plan. Yet, they also realize that they need a 401(k) retirement plan in order to attract and retain quality employees. What they don't know is that as the fiduciary for the plan, they are ***personally liable*** for anything that goes wrong with the plan.

Recently the Department of Labor hired over 600 "investigators" to go out and find retirement plans of all shapes and sizes that are out of compliance. Unless business owners have implemented solutions, they are personally exposed to the consequences. We've summarized the various areas of risk facing the employer.

Provider Risk

Qualified retirement plans use many providers, including recordkeepers, third party administrators (TPAs), investment managers, custodians, consultants, and legal counsel. Under ERISA Section 3(16) the fiduciary of the plan, which is typically the business owner for small businesses, needs to have a prudent process when selecting and monitoring providers for the plan.

The plan fiduciary should consider a comprehensive administrative audit of the recordkeeper and TPA every three (3) years. This should include a careful review of the providers' annual SSAE 16 reports, plan reports, customer facing service delivery model, various industry related survey data and ratings, and an analysis of actual plan administration compared with the requirements contained in the plan document. In addition, the plan fiduciary should conduct an outside search of other providers and send out a request for information (RFI) or a request for proposals (RFP) to at least three outside providers. With an RFP, the plan fiduciary can determine if the services and fees provided by their current providers are serving the needs of the plan at a reasonable cost.

To reduce provider risks, the plan fiduciary should take these four steps:

1. Implement a retirement plan committee and charter to provide governance over the administrative provider selection and monitoring process.
2. Review all fees and perform a benchmark study at least annually to ensure the plan and participants are paying reasonable fees for the services provided.
3. Ensure that plan fees are allocated in an equal fashion among the plan participants.
4. Document the policies and procedures to ensure accurate ongoing administration of the plan.

What most plan fiduciaries and providers don't know, is that plans with mutual funds or annuities as investments have fees that are used to offset administrative fees. These fees are typically referred to as revenue sharing and the recordkeeper recaptures these fees and places them in an ERISA account setup for the plan. On a periodic basis, these fees are distributed to providers that are servicing the plan and they are also allocated back to participants. Because the fees are allocated back based on the investments the participants have elected, it can be interpreted as an inequitable allocation of expenses. An equitable allocation would be to exclude the use of investments with revenue sharing and use either exchange traded funds (ETFs) and/or collective investment trusts (CITs) that have no revenue sharing built in. Plan fiduciaries should keep the plan clean and fully transparent ensuring all participants are paying the same amount.

Investment Risk

The area which carries the most risk for a retirement plan are the investments. According to Spectrem's 2015 Market Insights Report, assets held in employer-sponsored retirement plans increased 11.5% to reach $11.3 trillion at the close of 2014. Most of the recent litigation with retirement plans have been specifically on the expenses and performance of the investments. As the baby boomer generation continues to retire in droves, many will have an inadequate retirement balance and there will be a slew of law suits filed against the fiduciary of the plan.

To significantly reduce investment risks, the plan fiduciary should take these steps:

1. Conduct a search for an ERISA 3(38) Investment Manager that will take on full discretion over the investments in the plan.
2. Include the ERISA 3(38) Investment Manager in the Retirement Plan Committee.
3. Have the ERISA 3(38) investment manager draft an investment policy statement (IPS) specifically for the plan that includes processes for selecting, monitoring and replacing investments in the plan.
4. Review investment performance on a quarterly basis.
5. Document and keep on file the quarterly investment reviews, IPS, and the investment selection, monitoring, and replacement policies.

Compliance Risk

Plan fiduciaries do not always follow all the provisions of the plan document and investment policy statement (IPS). Many plans become noncompliant when they make impermissible loans, unqualified distributions, exclude eligible employees, fail to replace investment options in accordance with the IPS, or use the correct definition of compensation.

There is little doubt that that the improper administration of a defined contribution plan can drive up costs. Higher costs from inadequate retirement readiness and/or Internal Revenue Service (IRS) or Department of Labor (DOL) penalties represent preventable financial burdens. Moreover, as recent litigation has demonstrated, retirement plan fees that are too high, that are collected inequitably, or that are not transparent enough can result in significant legal fees and settlement costs.

Retirement Readiness Risk

A major risk for qualified retirement plans is not meeting the goals of the participants upon retirement. If a plan fails to meet its goals, employees may not have sufficient retirement assets and, as a result, may delay retirement. There have been many studies that have concluded that education only marginally increases retirement readiness.

One of the key indicators that plan fiduciaries look at is the performance of the plan. Appropriate plan design and investments has evolved over time and the latest shift has been on retirement readiness.

In 2015, the Pension Rights Center updated its aggregate U.S. retirement income deficit figure to $7.7 trillion—up from $6.6 trillion just five years earlier. It's obvious, the vast majority of people will not have enough money to retire. There are several key plan design features that can drive the success of a plan. The chart below summarizes several automatic features to improve retirement readiness.

Driver	Old Way…	New Way…
Get more people in the plan.	Employee elects to enroll in the plan – 60% to 70% participation rate.	Auto-enrollment – 92% participation rate.
Auto-enrollment rate that won't hurt participation.	*3% of compensation.*	*6% of compensation.*
Have participants contribute more.	Employee decides when to increase contributions.	Annual auto-escalation.
Auto-escalation percentage that won't hurt participation.	1% increase every year up to 6%.	2% increase every year up to 15%.
Use the company match to increase participation.	50% on the first 6% of compensation.	25% on the first 6% of compensation AND 25% on the next 6% of compensation.
Strengthen investment asset allocation.	*Participant self-directed.*	*Model portfolios with managed accounts and QDIA.*

We all know that the qualified plan market place is huge and according to a SPARK, survey conducted in 2012, there are close to 550,000 plans representing $3.5 trillion in assets.

Plan Assets	# of Plans	# of Participants (000s)	Assets ($Billions)
< $1M	355,000	8.4	$145
$1 – 10M	168,500	15.6	$500
$10 – 50M	17,600	13.1	$375
$50 – 250M	4,300	13.8	$530
$250M – 1B	1,100	11.6	$550
> $1B	500	18.4	$1,465
Totals	547,000	80.9	$3,565

Your Roadmap to Success

For advisors that are either new to the 401k market or may have a couple of plans, they are searching for simple solutions to prospect and service qualified retirement plans. The successful advisors are delivering a comprehensive plan review that addresses the various risks associated with a qualified plan. Yet instead of assembling all of these services, advisors need a single source where services are bundled including fiduciary services, professional money managers, and an easy-to-follow roadmap to pursue retirement plans. What are the steps to success?

Step 1 – Advisor Education

You need detailed training modules help you learn the retirement plan process from prospecting to ongoing servicing.

- Module 1 – Basic Plan Design
- Module 2 – Complex Plan Design
- Module 3 – ERISA 3(38) Overview
- Module 4 – Prospecting
- Module 5 – Sales Meetings
- Module 6 – Closing the Sale
- Module 7 – Servicing the Plan
- 401k Fee Cases
- ERISA Litigation
- Other Litigation
- Annual Plan Survey
- Lower Fees for 20 Years
- Lower Fees for 40 Years
- 2014 Plan Sponsor Survey
- BrightScope Fee Study

You need information to help guide and train you throughout the sales process.

- First Appointment Guidelines
- Second Appointment Guidelines
- Service and Education Worksheet
- Service Commitment Letter
- Sample Service Summary Calendar
- Annual Review and Agenda
- Financial Professional Evaluation
- Rollover Chart
- Retirement Plan Comparison Chart
- Fiduciary File
- Retirement Plan Fact Finder
- Sample Non-Fiduciary Advisory Agreement

Step 2 – Prospecting

Whether you like to cold call prospects or you use a third party service, you need a solution that provides the prospecting and lead generation data and tools in order for you to be successful in winning plan business.

- Fee Call Script
- Service Call Script
- Fiduciary Call Script
- T3 Appointment Setting
- Service Prospect Letter
- Fiduciary Prospect Letter
- Fee Prospect Letter
- Plan Review Call Script
- Sample Litigation Letter
- Cash Balance for CPAs

Step 3 – Discovery Meetings

The most important thing to remember for the first discovery meeting is to ask probing questions and let the client do the majority of the talking and explanations. They will give you valuable information and insight into the plan which will help you later on. Additionally, you want to ask for more and not less, as you want to convey that you are an expert in the retirement plan field. Research the company, so that the more you know, the better your proposal. Position your request for documents as part of the comprehensive plan review process as this will emphasize your expertise. Be sure to ask about how participants are being educated on the plan, how old is the workforce, what is the plan paying for specific services? Are the services and fees reasonable? What value do you provide for your own fees? You also want to check for fiduciary concerns and potential liabilities. In general, the meetings will follow the sequence described below:

1. Discovery and information gathering…ask questions and show the process!
2. Proposal and Presentation of Findings….present and fine-tune for the finalist presentation.
3. Finalist Presentation…set yourself apart from the competition.

Step 4 – Comprehensive Plan Review

A comprehensive plan review should include all of the following:

- Document Checklist
- Fee Assessment Worksheet
- Investment Monitoring Report
- Fee Benchmarking Report
- Plan Comparison Report
- Fiduciary Concerns Checklist
- 401(k) Checklist
- 404(c) Checklist
- How to Read a Form 5500
- Plan Design Benchmarks

Step 5 – Closing the Sale

Under this phase, you really want to emphasize the process. The knowledge of investment products is just a starting point. To really set yourself apart, show the plan fiduciary that you have a well-developed process to proactively fulfill your commitments and to coordinate with a TPA and/or recordkeeper. Additionally, you also want to establish realistic expectations for service and the more specific you are, the easier it is for prospects to imagine working with you. Be sure you can live with what you offer, based on the plan's revenue potential and your own time availability.

The exhibit below shows some of the key areas to prepare for and address during the finalist presentation.

Have you...	Benefit
...forwarded a meeting agenda in advance?	Demonstrate your commitment to following a process.
...brought samples of your education materials?	Show you are ready to engage employees in a meaningful way.
...prepared a Service Summary, Education Policy Statement and Planning Calendar?	Allow prospect to envision the experience of working with you in detail.
...reviewed your notes from past meetings to make sure you have addressed all issues raised by prospect?	Make clear that you listen and respond to client concerns.
...left time for questions/discussion after presentation?	Address any objections and, if necessary, allow time to coordinate solutions with other service providers.
...if you are presenting with representatives from other service providers, have you rehearsed together or conducted a "dry run" in a conference call?	Instill confidence that you can assist plan sponsor in coordinating everyone's contributions to the plan.

Step 6 – Servicing the Plan

The primary objective of the plan is to provide sufficient income during retirement for participants. This is commonly called retirement readiness and to that end, plan fiduciaries are looking for the following key attributes in an advisor who is overseeing their plan. The table below shows the important elements that a plan sponsor will use to monitor the advisor on the plan.

Managing Costs	▪ Monitoring and negotiating fees. ▪ More focus on competitively priced investments. ▪ Maximize access to the lowest level fees. ▪ Ensuring transparency and reasonableness.
Compliance With Regulations	▪ Fiduciary responsibility is more important now. ▪ Ensuring plan is in compliance with regulations.
Investments	▪ Ensuring that selected funds are right for participants. ▪ Want more expertise in making fund changes.
Fiduciary/ Regulatory Support	▪ Plan Sponsor is more involved in the selection and monitoring of the advisor. ▪ Want an advisor who wants to be the best and wants to create the best retirement plan. ▪ Advisor is looked as an extension of the Plan Sponsor in driving participation and communication the value of the plan.

Conclusion

Most small business owners don't realize that they are the fiduciary of the plan and personally liable. It's critical that advisors bring in a qualified ERISA 3(38) investment manager to oversee the investments in the plan as the investments carry the highest risk for litigation. Additionally, advisors should conduct a comprehensive plan review for the sponsor of the plan. In order to gather these resources and efficiently serve the 401(k) marketplace, advisors must look to partner with an RIA that has the ERISA 3(38) investment management, education, processes, documents and back-office support that enables advisors to go after 401(k) plans in an efficient manner.

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For more information, please contact Redhawk at either retirement@redhawkwa.com or (952) 835-4295.