

## How to Select a Retirement Plan Solution And Protect Yourself From Liability

### Executive Overview

As a savvy business owner or benefits administrator, you recognize that your company's retirement plan can provide a substantial benefit for your employees, while helping you attract and retain quality talent. Properly established, a well-managed retirement plan can be a win-win for everyone. But there also are plenty of pitfalls. How do you offer your employees robust retirement plan benefits, nimbly avoid the obstacles, and optimize your opportunities – without having the effort overwhelm available resources?

Here, we offer:

- An overview of the retirement plan industry.
- An exploration of its inherent challenges: hidden costs, burdensome oversight, volatile markets and fiduciary liability, to name a few.
- Qualities worth considering as you evaluate various retirement plan solutions, such as the quality of its recordkeeping and compliance, technology, communications, investment management, costs and overall offering.
- A sample list of handy Request for Proposal (RFP) questions you can include in your evaluation process.

For additional information about retirement plan selection and investment strategy, we encourage you to visit [www.alignmy401k.com](http://www.alignmy401k.com).

### Retirement Plan Industry Overview: What Every Plan Sponsor Should Know

The Employee Retirement Income Security Act (ERISA) of 1974 is the body of law that currently governs qualified retirement plans, including 401(k) plans. If you establish a 401(k) plan for your business, you become a **plan sponsor**. As a plan sponsor, you become subject to several high standards of prudence required under ERISA. And by “you,” we aren’t just talking about your limited liability company. We mean that *you* as an individual can be held personally liable should your 401(k) plan fail to meet these ERISA standards:

**STANDARD OF PRUDENCE** — Under ERISA, investments must be selected “with the care, skill, prudence and diligence... that a prudent man [or woman] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims...”

— ERISA § 404(a)

**PRUDENT EXPERT RULE** — “ERISA's prudent standard is not that of a prudent lay person but rather that of a prudent fiduciary with experience dealing with a similar enterprise.”

— *Marshall v. Snyder* 1EBC 1878, 1886 (E.D.N.Y. 1979)

**TEST OF PRUDENCE** — “ERISA's test of prudence... is one of conduct and not a test of the result of performance of the investment. The focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investments succeeded or failed.”

— *Donovan v. Cunningham* 716 F. 2d 1455, 1467 (5th Cir. 1983)

In other words, you don’t have to guarantee employees a certain return on their investments. But you do need to be able to demonstrate that you chose your plan and its investment options prudently, for reasons that reflect your fiduciary obligation to act in your employees’ best interests.

Did you select your retirement plan in part because the relationship was familiar, such as a friend or acquaintance, relative or manager for your personal wealth? If so, you also should have an RFP or similarly documented cost/benefit analyses on file, to demonstrate that you selected the service provider according to a fiduciary-level of decision-making prudence.

It also doesn't hurt to periodically revisit your existing plan selection. Even if you are relatively satisfied with your current plan, by conducting an RFP every few years, you can verify whether your services are current with available opportunities and simultaneously protect yourself by demonstrating (by having on file) an ongoing commitment to your fiduciary duties as a plan sponsor. You can view an illustration of the benchmarking analysis we provide plan sponsors by navigating to the sample [B3 Provider Analysis™ Fee, Service and Benchmarking report](#) in the Fiduciary Folder at [www.alignmy401k.com](http://www.alignmy401k.com).

### **What's All This About Fiduciary? I Thought I Was a Business Owner.**

As touched on above, when you establish a 401(k) plan, you become the plan sponsor, subject to liabilities based on your role as the plan's **fiduciary**. In plain speak, a fiduciary is someone who is acting on another's (a beneficiary's) behalf in a financial capacity. For 401(k) plans, you, the plan sponsor, are the fiduciary; your employees, the plan participants, are the beneficiaries.

By law, a fiduciary must act exclusively in beneficiaries' highest financial interests when representing them, even if it means sacrificing his or her own best interests. In other words, plan sponsors may be failing to act as a fiduciary if they select a plan manager based on personal preferences or conveniences, especially if it can be demonstrated that there are other plans available that would better serve the participants' needs.

Fortunately, there are plans available that ease many of the plan sponsor burdens *and* serve participants' best interests. We'll get to some of the key characteristics to seek in a moment. But first it helps to be aware of the type of alliances currently available, particularly as they relate to the levels of fiduciary obligation you can outsource to professionals.

As a plan sponsor your basic responsibilities and liabilities are two-fold:

1. **What** -- Selecting, monitoring and replacing the plan's **investment options** (i.e., the funds, securities or other investments available within your plan)
2. **Who** -- Selecting, monitoring and replacing the **investment manager** (i.e., the entity overseeing your investment options)

Because you are a business owner, not necessarily a financial specialist, ERISA authorizes you to retain an investment advisor who is. That advisor can take on both the operational and fiduciary burden of the "what" (the investment options), relieving you of this challenging liability. This is accomplished by written agreement between you as the plan sponsor and the advisor, who legally accepts the duty of serving as an **ERISA section 3(38) investment manager** for your plan. By signing this contract, the advisor also becomes an **ERISA section 405(d)(1) independent fiduciary** to the plan, which makes the advisor solely responsible and liable for its investment decisions concerning the selection, monitoring and replacement of plan investment options.

Thus, half of your fiduciary duty can (and we might suggest, often should) be fully delegated to a professional advisor who is qualified to prudently manage the obligation.

But then there's the other half — the selection of that advisor to begin with. At least under current ERISA regulations, manager selection is an obligation that the plan sponsor cannot outsource. You always retain the duty to select, monitor and replace the "who," or the investment manager. And as you might expect, not all managers are created equal.

## Managing the Investment Manager Selection

Until recently, very few advisors to retirement plans would accept the full role of a 3(38) investment manager, which meant accepting significant fiduciary responsibilities and liabilities. The majority of traditional retirement plan advisors typically offer plan sponsors more limited assistance in carrying out their duties related to investment selection. They may help with monitoring services, selecting fund managers, and providing related operational support such as helping you establish and maintain a “fiduciary file,” with necessary paperwork to substantiate that you are meeting your compliance obligations. And while these services help to document the fulfillment of your duties under ERISA, they don’t rid you of any liability. You receive assistance in fulfilling your fiduciary obligations, but at the end of the day, they remain your obligation.

These days, an increasing number of investment advisors will take on the role of an ERISA section 3(38) investment manager, in some cases at competitive costs compared to those who don’t. As described in a Morningstar article overview on ERISA fiduciaries, “An ERISA section 3(38) fiduciary can only be (a) a bank, (b) an insurance company or (c) a registered investment adviser (RIA) subject to the Investment Advisers Act of 1940. This means that a stand-alone broker-dealer, for example, cannot be an ERISA section 3(38) fiduciary.”<sup>1</sup>

Another option you may see are plan advisors bearing the “co-fiduciary” label, sometimes referred to as an **ERISA section 3(21)** manager. Again, a 3(21) advisor can provide various levels of support services you may or may not need, but only minimal legal relief from fiduciary responsibilities and liabilities for selecting, monitoring and replacing plan investment options. Yet another option is to retain a non-fiduciary advisor such as a broker or insurance agent, and receive only the support services with no relief from fiduciary responsibilities and liabilities.

For savvy retirement plan sponsors, the choice seems clear:

*Seek an ERISA section 3(38) investment manager relationship for your 401(k) plan management.*

### Better Ways To Do 401(k)s

Even if you narrow your selection to 3(38) investment managers, there are characteristics that separate one from another. By considering these additional qualities, you can seek to deliver a robust 401(k) plan to your employees and manage your fiduciary obligation to prudently select its investment manager.

In our view, these represent minimum standards a retirement plan sponsor should require in selecting an advisor, providing you with a framework for detecting the difference between the great majority of advisors that merely sell products and actual experts that specialize in providing truly valuable services to retirement plans.

#### Independence/Objectivity – Fee-Only

The investment advisor to a retirement plan should be free from any real or perceived conflicts of interest, with no allegiance to any entity except its client, the plan sponsor and participants. An important way to substantiate this level of commitment is to look at the firm’s fee structure. Is the firm “fee-only,” with its sole source of income the fees you pay? Or does it accept commissions or other forms of compensation from third parties that may represent conflicts of interest?

In addition, firms with the preferred, fee-only model should be happy to disclose all expenses in a straightforward format that best enables you to make apples-to-apples comparisons in your due diligence. Of course when all else is equal, lower costs will be preferred.

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<sup>1</sup> W. Scott Simon, “[The Different Flavors of ERISA Fiduciaries.](#)” Morningstar Advisor Fiduciary Focus, December 3, 2009.

### **Prudent Investments – Investment Policies**

It's still important that your chosen investment manager be well-positioned to represent your employees' best interests with its investment activities. Your plan advisor should provide a legally sound, academically oriented and cost-efficient prudent investment process that's designed to protect you and your plan participants. One way to help substantiate this capability is to ensure that the manager offers you a written Investment Policy Statement that clearly describes its policies and activities on behalf of your plan.

### **Customer Service Standards – Investment Advisory Agreement**

It almost goes without saying that upfront and ongoing excellent customer service is critical to your plan's success. And yet, particularly if you're exploring a new relationship, it may be difficult to separate the talk from the walk. It can help if the firm is willing to put the commitment in writing. A firm with the level of customer service you deserve should be agreeable to enter into a legally binding investment advisory agreement with you that acknowledges the firm's delegated responsibilities in a clear and concise way, reviewed annually for potential updates.

### **Excellent Education: Investor Behavior**

The advisor to a plan should provide a customized investment education program to plan participants in accordance with Interpretive Bulletin 96-1; Participant Investment Education; Final Rule, issued by the Department of Labor.

So, yes, an investor education component is required by law. But it also can be critical to your plan participants' expected outcomes.

Studies have demonstrated that individual investors are often their own worst enemies. Investors who form their strategy and model their portfolio according to their own goals, risk tolerance and time horizons – and then stick to that strategy and portfolio over the long-term – stand the best chance of capturing expected market returns toward achieving those goals. Instead, investors are all too often tempted by exuberance during bull markets and by fear during bear markets to chase or avoid past returns, rather than staying the course. As a result, they often end up underperforming the very funds in which they've invested.

By offering your plan participants the education and understanding needed to make sensible decisions for their retirement account, avoiding the return-damaging tendency to over-trade, you may well be offering your employees the most important benefit of all. You can measure the success of your investment manager's educational program by determining whether it focuses on the investment behavior of plan participants as described here.

### **Credentialed Expertise and Hands-On Experience**

The investment advisor to a retirement plan should have "book smarts." The advisor's education, training and credentials should be directly related to expertise in retirement plan investment and management. An advisor should be able to articulate and demonstrate how its expertise is a benefit to a plan sponsor and each plan participant. One (among other) respected credentials is that of the Certified Financial Planner® or CFP® practitioner.

The advisor to a retirement plan should also have "street smarts." Inquire whether the advisor has consulted with businesses and organizations in the area of qualified retirement plans, and if so, for how long. Avoid relationships with those who seem fixated on selling additional products and services to you or your participants, or on soliciting non-retirement business. Seek a relationship with an advisor who can offer seasoned, practical experience working with investors on a daily basis. Your advisor should provide you with a selection of low-cost, variously diversified model portfolios, so employees can participate according to their own goals as well as the tenets of sound investing. Such an approach helps address both participants' best interests and your fiduciary obligations.

### An RFP Checklist

According to the qualities described above, following are requests you can include in your RFP to help you assess new retirement plan opportunities.

- ✓ **Fiduciary Role** — Is your firm able and willing to take on the role of an ERISA section 3(38) investment manager? Will you sign a written agreement and help me maintain necessary paperwork in an easily accessible fiduciary file?
- ✓ **Compensation** — Are you fee-only, fee-based (advisor fees and some commissions) or commissioned? Describe the rationale behind your compensation structure. Can you and will you disclose all expenses incurred by our plan in writing – both those incurred by the plan sponsor and the plan participants?
- ✓ **Planning** — Will our plan include a written Investment Policy Statement that describes and explains its structure and offerings? If/when changes are made, will the IPS be updated accordingly?
- ✓ **Structure** — Describe the model portfolios or other fund offerings you provide, including their structure. Are they institutional class with transparent, competitive expense ratios?
- ✓ **Service** — What are your service offerings and will the services we can expect to receive be documented in detail in an Investment Advisory Agreement?
- ✓ **Education** — What do your educational materials and services include? Describe your core philosophy on how markets operate, and how you advise investors to best capture expected market returns within their individual retirement accounts.
- ✓ **Qualifications** — Describe credentials, experience and related expertise, as a firm as well as for our key contacts at your firm.

As a business owner, you provide current income for your employees. Your company's retirement plan can provide meaningful benefits for their future security and can help you attract quality talent. But there are only so many hours in the day. You want to ensure that your 401(k) plan is easily understood; simple for you to manage; economical for your business; effective for your employees; and, for your protection and theirs, managed according to their highest interests.

That's a lot of "wants" to balance. At the same time, perhaps no benefit is more valuable to an employee than his or her successful retirement. If you haven't done so recently, it seems worth exploring whether your current 401(k) plan includes the qualities necessary to endure. And now, you've got an RFP checklist with which to begin.

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### About Align Wealth Management

With its roots dating back to 1993, Align Wealth Management (Align) is a fee-only, Registered Investment Advisor firm headquartered in Oklahoma City, Oklahoma with a satellite office in St. Petersburg, Florida. Align advisors are Certified Financial Planner® practitioners who help individuals and families manage their wealth in a tax-wise manner, according to their long-term goals and risk tolerances. The firm also manages 401(k) plans with a similar, goals-based approach. For individual investors and retirement plans, the firm operates at a fiduciary level of care, in which clients' interests are top priority in its actions. Align is "Client Focused. Period."