As an advisor who focuses exclusively on retirement plans, I speak to a lot of plan sponsors and trustees. On the forefront of everyone’s minds are questions such as “Am I paying too much for my plan?” or “Are my funds outperforming the markets?” or “Do you give advice to my participants?” Although these are all great questions, and ones I will certainly address in my five-part series, the one question I like to ask first is this: “Do you know what your duties are as a fiduciary to a retirement plan?” Exactly! That is the look I typically get when I pose the question.

Very few small business owners, managers or executives seem to take the time to appreciate the single most important concept of running a retirement plan. As a plan sponsor, or steward, you are responsible and have a legal duty to act in the best interest of the person and organization that has entrusted you with the management and control of their retirement assets. Does it include fees, investment choices, provider choices, whether or not participants have access to education, risks and conflicts of interest? You bet. And then some! It is in my opinion that not enough plan sponsors take this seriously, let alone understand the scope of their duties and responsibilities. And although these duties can be shared, they can never be abdicated. Ignorance, or being too busy running a business or organization, is not a viable defense.

So what to do? The first step is to both recognize and accept that you are a fiduciary; that you have the legal responsibility for overseeing someone else’s retirement plan assets. Whether you are the owner of the business, a trustee, the plan sponsor, a board member, or a member of the investment committee, you are a fiduciary. Second, you must understand and have an awareness of what your duties and responsibilities are. Third, you should perform a self-assessment and do what I call gap-analysis: What should we be doing, what are we doing or not doing, and what are the gaps that carry the most consequence, the most risk, or the most liability? Start there. Make a plan. Take action.

Like strategic planning, these important exercises take time and energy, but ignore or put them off at your peril. Not only do you expose yourself to increased risk of lawsuit or penalties from the Department of Labor, you may cost precious retirement plan assets from the very employees who help build and maintain your business. This happens through misunderstanding fees and who gets paid from them, reluctance to switch providers or your advisor, or disinterest in employee education because it takes time away from productivity, or you think no one is interested.

As a registered investment advisor (RIA), Fragasso Financial Advisors acts as a co-fiduciary to our clients’ retirement plans. (Registration does not imply a certain level of skill or training, nor any regulatory endorsement of approval of our investment advisory services.) We help owners, directors, trustees and committee members understand their role as a fiduciary to their plan. We do not outsource this responsibility. Does your advisor take on this role and this level of responsibility or do they outsource it? Is it in writing?

PART 1: SO YOU ARE A FIDUCIARY!
PART 2: PLAN DESIGN MATTERS... A LOT!

In the first part of my series we talked about the role and duty of the fiduciary, and the important steps of acceptance and adherence to the fiduciary standard. In this segment we will look into how the plan is structured: what we call plan design. Whether you have a current plan or are thinking of starting a retirement plan, it is critical to understand the many choices you have as a plan sponsor. Most business owners and trustees do not fully appreciate the various types of plans available, the options within those plans, and how more than one plan works in conjunction with the others. Because I have these conversations on a regular basis, I can assure you that a low percentage of the people I talk to have any idea about plan design. And there is plenty to discuss! Read on.

When I take a step back to try to understand why so many plan sponsors have such little knowledge about the subject of plan design and the many potential possibilities of structuring a retirement plan, I believe it is primarily due to the high percentage of financial advisors who choose to focus the majority of their practice on individual investors. The average advisor may have only two or three retirement plan clients. I call them “one-off” advisors. They have a good book of individual clients, and two or three of those clients ask the advisor to “manage the retirement plan,” which they do. But because of this lack of focus or concentration, they simply do not speak the language of the qualified or non-qualified plan. To the average retirement plan sponsor, it may seem logical that a financial advisor who does a good job with individual asset management would also be effective with retirement plans. But that isn’t always the case. I believe this misunderstanding leads to a great disservice to both the organization who sponsors the plan and to the participants. Plan sponsors usually wind up with something that is sold to them by someone who represents a product. I call it a “401(k) in a box.”

I’ll step away from my soapbox but I cannot emphasize enough how important it is to understand this distinction.

Because there are too many specific types of plans to list, with as many options available in those plans, I will attempt to touch on a few examples, in order to get the conversation started.

At a high level, the first thing a retirement plan advisor must understand is what the organization is trying to achieve with their retirement plan. For example, are we trying to attract and retain quality employees? Are key employees highly compensated? Will the plan offer employer contributions, and if so, will they meet one of the many safe harbor requirements to pass testing? If not, will the highly-compensated employees even be able to fully participate, and if so, will the standard contribution limits of the qualified plan even be enough? Has a non-qualified plan been considered? And if so, what are the pros and cons of informally funding or not funding the plan? Each of the answers to these questions will lead to more questions.

Another goal of the plan may be to help employees retire, or to increase the participation or savings rate. There are some tools such as auto-enrollment or auto-increase that are wonderful to use, in order to help effect the outcome in a positive manner. So why do so few plans have these features selected? I believe there is a lack of understanding in how these features work, and what results they produce. I get the same resistance when the ROTH option comes up in our discovery meetings. Once the plan sponsor understands how the ROTH option works, how easy it is to administer, and that the participant, and not the owner or trustee, may want the
option to utilize the tool, we tend to make headway.

In Part 3, I will discuss in more detail the topic of selection and monitoring of investments in retirement plans. For the sake of the plan design discussion however, we need to determine first the type of investments to include. For example, do we want a guaranteed annuity option, a money market or stable value fund? Should we offer active or passive managed funds, or both? Other decisions to be considered are whether or not to offer managed advisory services that charge the participant an extra fee or brokerage windows that allow unlimited investment selection outside of the plan. There are pros and cons, fees, risks and potential rewards for each of these choices. And if the broker or advisor is not a fiduciary, who will actually provide the plan sponsor advice as to which of these options is best suited for their particular plan participants? If you ask the plan provider, and they happen to package their own stable value fund or target date funds for instance, are you able to understand the conflict of interest when discussing the best fund choices? These are all very important questions and the choices you make can either increase or decrease your liability to the plan participants.

One of my favorite discussions to have with small business owners centers on what I call “owner benefit.” Most small business owners work their entire lives building their respective businesses. They sock away the usual plan limits of the qualified plan inflated a few thousand dollars every couple of years. But they rarely understand how to maximize their allowable contributions, due to the perceived limitations of the plan. For example, if there are 30 employees, they typically would not consider a profit sharing contribution. 1/30 of the total profit is appealing to few business owners. Maybe they even underpay themselves and try to limit payroll taxes. As a result, they pull money from the business through distributions and pay enormous taxes. One of my first questions is, “If you had an investment vehicle that is tax-efficient, would allow you to put away in excess of $200,000 per year and would also benefit all or most of your employees, would there be any interest in exploring it?” I am often asked whether this is a new option or why their current advisor or CPA has not discussed this in the past. I assure them it is not new. By using the profit sharing plan, specifically a new comparability, age weighted or social security integration allocation, coupled with the 401(k) feature, and by adding a cash balance plan, owners have the opportunity to tax defer up to $265,000 in 2016. This is always a good time to bring the CPA into the conversation for the necessary tax advice.

Lastly, I often get calls from organizations to start a new plan. Should they start a 403(b), a 401(k), or a SIMPLE IRA? What are the costs of administering each of these options, the regulatory requirements, participation rates, options and restrictions for both the participant and the organization? I am surprised (not really) as to what answers plan sponsors get from the various advisors and plan providers they call or are referred to for advice and/or quotes. This is an important topic and plan sponsors need to understand not only the options and limitations that exist for the organization looking to start the plan, but also with those they call for help. For instance, are they calling a 401(k)-only provider and asking if they should start a 401(k) or a SIMPLE IRA? I think we know the typical answer because I hear it all of the time. “You should start a 401(k)” they are quickly told.

Good advice needs to be unbiased. Conflicts need to be disclosed. Complex and important decisions such as how to effectively manage or start a retirement program requires all parties to have a clear understanding and discussion about the many options available. They must be willing to spend time asking and answering pertinent questions and not rushing to solutions. And they must have a clear understanding of the needs and direction of both the sponsoring organization and its principals.

Sources: 1 IRS IR-2015-118: The annual compensation limit under Sections 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) remains unchanged at $265,000.
PART 3: RETIREMENT PLAN FEES AND THE MATRIX

Before a plan sponsor can determine whether or not fees are reasonable, they must first understand what the fees are. A study by the U.S. Government Accountability Office of 1,000 plan sponsors found that 50 percent of plan sponsors “did not know if they or their participants paid investment management fees or believed these fees were waived.” A whopping 82 percent had not asked about Sub-TA fees that reimburse the record keeper, and 70 percent had not asked about 12b-1 fees, which are used in part to market and distribute the funds. Half of the respondents did not ask about excess broker commissions, trading costs or wrap fees. Even though this is a fiduciary responsibility, the study clearly shows the fee discussion manages to elude the majority of plan sponsors. Too busy to check?

Let’s look at the long-term cost to the participant. A Wall Street Journal article in November 2015 pointed out that for the difference in share classes of the same mutual fund, but with expense ratios of 1.39 percent for the R-1 and .64 percent for the R-6, an investor who contributes $5,000 per year for 40 years, the higher cost fund will erode $130,000 from the investor, or 17 percent of the investor’s entire savings.¹ This doesn’t have to happen to you or your employees.

This is not new. Despite the multitude of articles published in various newspapers, journals and magazines, the many whitepapers, lawsuits and best practices guides from various organizations, the practice of over-charging what is necessary continues today. The best comparison I have is that of The Matrix. In the movie, Neo, played by Keanu Reeves, must first get inside The Matrix before he can understand how to break its code and control it, instead of being controlled by it. It is important for plan sponsors to “break the code” of retirement plan fees, in order to best position themselves and their employees to have the greatest chance at a successful retirement.

I will end with one example of how to get out of the matrix: unwind and unbundle all of the fees in your retirement plan. Separate all costs from all providers where able. Reduce or eliminate all revenue sharing arrangements. Put your advisor on a fee-based compensation as a percentage of plan assets or a flat fee. Use institutional or the lowest share class funds available for your plan size. Renegotiate as your plan grows. Pay as much of the administrative costs from the company where you may get tax deductions for the business, instead of out of participants’ accounts where you get none. Do not allow brokers to get a finders-fee commission upfront for moving the plan to another provider. These tips are not all-inclusive and your plan may have nuances that prevent the use of these strategies. There are additional strategies. But if you are not having these types of conversations with your advisors or providers, we should talk.

¹ GAO-12-325 Survey of the 401(k) Plan Sponsors
² WSJ “Why You Should Check Your 401(k) Plan’s Fees,” November 9, 2015
“Too many investment options,” “underperformance,” “retail share class,” “inappropriate benchmarks.” This is just a sampling of claims made in a rash of recent lawsuits filed against seven major universities.¹ And these lawsuit filings are not going to decrease in number or go away any time soon. In fact, they are only getting started. Blain Aiken, executive chairman at fi360 wrote, “Eleven major class-action lawsuits were filed in federal courts around the country... in the fourth quarter of 2015”.² These are large plans and easily exposed, right? Wrong. In Damberg et al v. LeMettry’s Collision et al,³ the case involves a $9 million plan, and alleges excessive fees.

Plan sponsors and trustees are responsible for major decisions that can have serious consequences for both the plan participants, the employees, and the plan fiduciaries. Through my work, I often see plans that have either a financial advisor with very limited experience advising plan sponsors, or no advisor at all, which is called a “direct” plan.

Plan sponsors and trustees are charged with a great deal:

- Which asset classes to include or exclude?
- What investment managers to hire?
- Whether to have actively managed investment managers, or passive investments that track an index?
- Do you need to replace underperforming investments that do not beat the index?
- What are the costs of your selections and who are all of the fees being paid to? Are they reasonable?

- Do you need the cheapest investment options?

Once these and many more important decisions have been made, you must document your process of how to monitor, replace and add investments on an ongoing basis. We also recommend there be a written policy that the participants can read should they have questions. The Department of Labor will request these documents should you be chosen for an audit, or worse, the courts will request them should you be named in a lawsuit.

The majority of the time, it is the advisor who specializes with individual clients and treats your retirement plan as though it is no different, or a representative from the recordkeeper who is not a fiduciary to the plan, that is giving you advice about these decisions. This should be the canary in the coal mine to plan sponsors everywhere. You must take this stuff seriously!

There are two primary ways you can help yourself and your employees with investment decisions. The first is to ask your recordkeeper if they partner with an investment firm that offers 3(38) fiduciary services. This service will provide you with a fund lineup, an investment policy statement, ongoing monitoring and investment replacements when needed. These are typically run by national and respected organizations and there is usually a fee attached with the service. The risk is that the decision to hire an investment fiduciary must be as a result of a prudent process and that you have determined they are an appropriate investment manager to your plan. Often you have only one choice from the recordkeeper, and the investment
Part 4 continued

Investment Decisions and Canaries

Selection is a one-size-fits-all lineup that is not personalized to your employees’ needs.

A second option is to hire a 3(38) investment manager that is independent of the recordkeeper. This option is more custom tailored to your specific plan demographic needs. With this arrangement, a financial advisor will typically sit down with you and discuss the many choices of investment selection, asset class, employee demographics, recordkeeper capabilities, and fees for your specific plan. Because there are no ties to the recordkeeper, this advisor should be in a position to provide advice and guidance across all recordkeeper platforms, in the event of the inevitable change that occurs from time to time over the years. There may or may not be a charge for this service, depending on whether or not the advisor is already paid from the plan or the plan sponsor.

At the heart of saving for retirement are the investment options your plan offers to your employees. If the selection is chosen carefully, if the fees are reasonable, and if you have a system of monitoring and replacing when needed, you are most likely providing a good opportunity for your employees to retire comfortably. On the contrary, if you leave this process up to someone who is not acting in the best interests of you or your employees, if the fees are too high and therefore the savings incrementally less, and if there is no documented plan indicating which investment options are appropriate for your employee demographics and when they should be replaced, you are not only hindering your employees’ opportunity to retire with dignity and savings, but you are very likely breaching your fiduciary duty. And this is a decision that only you have control over.

For Plan Sponsor Use Only – Not for Use with Participants or the General Public This information was developed as a general guide to educate plan sponsors, but is not intended as authoritative guidance or tax or legal advice. Each plan has unique requirements, and you should consult your attorney or tax advisor for guidance on your specific situation. In no way does advisor assure that, by using the information provided, plan sponsor will be in compliance with ERISA regulations. Blain Aiken and fi360 are not affiliated with Fragasso Financial Advisors or LPL Financial.

Sources:
PART 5: EDUCATION, PUPILS AND BARRIERS

I have been providing employee education since the early ‘90s. Back then it was insurance; today, it is about saving and investing for retirement readiness. What has changed is my service and offerings model. What hasn't changed is employee behavior and business owners' reluctance to embrace employee education.

I remember calling on a small exterminator with twelve employees years ago. The employer offered health insurance only, and the employees paid half of the premium. No life or disability insurance. No spending accounts. The insurance was not paid pre-tax at the time, as the tax code was new. The owner was interested in the tax savings to the company with a pre-tax plan. He was not, however, interested in the thirty minutes of individual employee time requested during working hours that I required in order to make sure that each and every employee was properly educated on both the benefits and the rules of using pre-tax dollars to pay for insurance and spending accounts. I remember to this day my argument on the phone with the owner: “You give me the time with your people and I’ll do a good job. Otherwise, I won’t set up your plan.” He agreed, and we set up the plan in an effort to get all of the employees to sign up for the various insurance benefits and to take advantage of the tax savings of the spending accounts available, and also for the employers need for the tax benefits.

So the answer is simple, right? Persuade business owners to just get their employees in a room once or twice a year and educate them, or send an email with various videos to review at will. These approaches are not always so effective. The problem is two-fold.

First, employees do not really know why they need to save. Those who think they do either put it off, save far less than needed, or they do it so reluctantly they look at it as a bill or a tax. The reasons for this are more complex. Saving for retirement has a longer time horizon than the average employee even stays with his or her employer. We get bombarded with advertisements for the latest cars, tech gadgetry, high-cost drinks or coffee, convenience foods, or other ways to spend our money. If you look at a product online, all of a sudden it shows up in your social media feeds, or you get a daily email reminder “the generator you looked at is still in the cart, Robert” (true story).

We as adults (and it continues to this day) have also not been properly educated about finance, debt, investing, or the value of compound interest. The subject of financial literacy is somehow not part of the curriculum in our schools. This, in my opinion, is one of the most important things to get “right” at an early age and to develop good habits that last a lifetime. The lack of this knowledge causes disastrous results for the majority of adults,
who have either taken on too much debt or worse, have not saved enough to even barely survive, let alone thrive, in retirement.

The other problem is that business owners are busy and often over-regulated. They feel they have to be more concerned with having to deal with the compliance side of running a retirement program, than with employee preparedness. An audience poll of retirement plan advisors, plan providers and broker dealers at the 2016 PLANADVISER National Conference, asked “What is your client’s main concern regarding their retirement plan?” 43% stated fiduciary responsibility compared to 27% who stated participant retirement readiness. 

Face it, business owners are also very busy. Their key employees and managers are busy. They all want their employees busy — busy working on their core duties. Many owners have a financial advisor to help them make important investment and financial decisions. They are typically financially literate. And for those owners who do care, and often ask their employees for input and what they may be interested in, they often fail to ask the right questions in the right way. The lack of responses reaffirm putting education low on the list of priorities. And so it goes.

Business owners and HR managers need to embrace financial wellness and retirement readiness for their employees. Do it for them; but of equal importance, do it for the business. Employees who save and invest properly have the ability to retire on time. This makes room for advancement in the organization and a constant stream of new hires. It improves morale and encourages development. It reduces health care costs and improves productivity. Employees who are educated about finance and debt, budgeting, saving, planning for emergencies, insurance for their families, will have a positive impact on the business. Take the necessary action and make available the time and topics that will encourage employees to engage. Help them learn to empower and energize their financial preparedness and readiness for both life while working, and life after retirement. It is good business and the right thing to do.

I’ll leave you with one last short story. A couple of years ago I helped an employee of a local company with a rollover of his retirement plan into an IRA at Fragasso. He had saved a nice mid-six-figure nest egg through his employer’s retirement plan. He told me that Bob Fragasso did a seminar for the employees of his law firm thirty years ago, that he paid attention, and immediately started saving and investing part of his paycheck. He was so happy telling me the story! To this day it warms my heart that Bob took the time to help this wonderful man.

For a no-obligation appointment and a comprehensive review of your financial preparedness and education policy, or ideas on how to start one, please contact us at 412-227-3200.

Source:
1. November-December 2016 PLANADVISER
For a no-obligation appointment and a comprehensive review of your plan investment lineup and investment policy,

CONTACT:
ROBERT YELENOVSKY
ryelenovsky@fragassoadvisors.com

610 Smithfield Street, Suite 400
Pittsburgh, PA 15222

Phone: 412.227.3242
Fax: 412.227.3210