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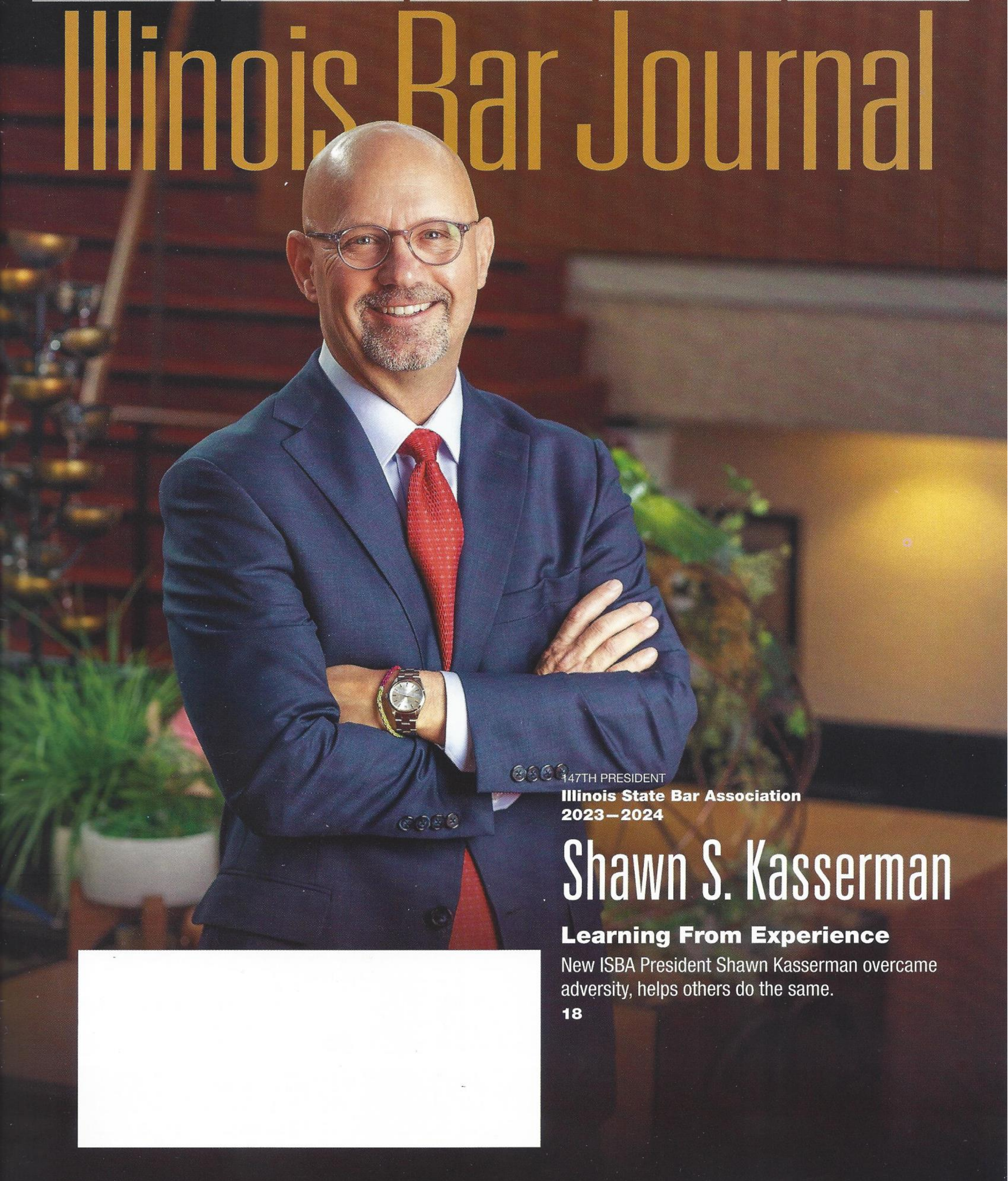

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Learning From Experience

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BY KURT WINIECKI

A Checklist for Retirement Plan Sponsors

Business owners who sponsor retirement plans like 401(k)s need help. Attorneys are in a perfect position to provide it.

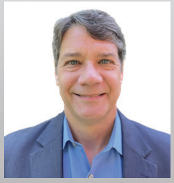
The problem: The Employee Retirement Income Security Act of 1974 (ERISA) requires plan sponsors to act as fiduciaries to retirement plan participants—that is, to make prudent plan decisions in the best interests of the plan's participants.[1] A significant amount of business owners who offer a retirement plan to their employees could be violating their fiduciary duties under ERISA's complex statutes. Lacking expertise and resources, smaller plans are especially vulnerable.

This article offers a documents checklist that helps attorneys determine whether a retirement plan sponsor is putting themselves at risk by violating ERISA's fiduciary requirements or failing to document prudent plan decisions.

Background

While large retirement plans are certainly not immune to violating ERISA's mandates,[2] smaller plans are typically at greater risk. We define small plans as those with less than $30 million in assets and fewer than 100 employees (of course, plans of all sizes need help complying with ERISA). Human resources professionals and office administrators are usually not ERISA experts and often cannot recognize potential breaches. Relying on conflicted or nonfiduciary advisors, third-party administrators, recordkeepers, and custodians can heighten, rather than reduce, legal risks. In short, busy plan sponsors need help understanding and fulfilling their fiduciary duties under ERISA.

1. The Employee Retirement Income Security Act of 1974, 29 U.S.C. 1001 *et seq*.
2. See, *e.g.*, *Hughes vs. Northwestern University*, 595 U.S. ___ (2022) (finding that plan sponsor violated its fiduciary duties under ERISA by failing to monitor investment options in the plan).



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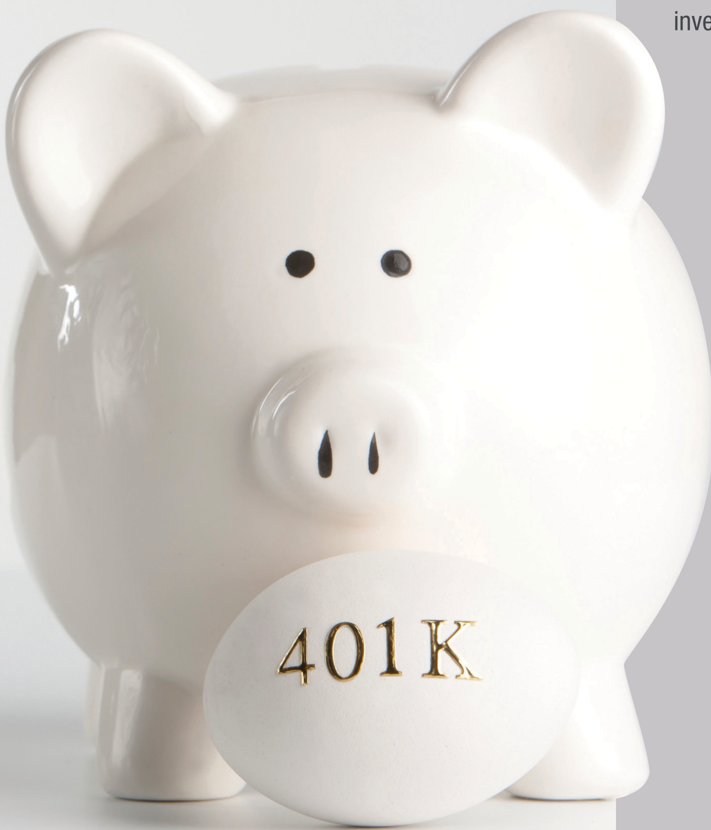
ISBA RESOURCES >>

- ISBA Free On-Demand CLE, *Overseeing Retirement Plan Investments: Understanding Your ERISA Fiduciary Obligations* (recorded Feb. 2019), law.isba.org/3MxmZjp.
- James Baker & Lisa Brogran, *Five Proven Tactics to Minimize ERISA Litigation Risk*, Employee Benefits (June 2014), law.isba.org/45qxBcm.
- Benjamin E. Gehrt, *A Warning to Public Sector Employers: ERISA Can Apply to You*, Employee Benefits (June 2014), law.isba.org/3oth9rK.

There are many reasons this is a big deal. First, the legal liability can be severe: Plan sponsors are responsible for employee retirement money, which is often a significant (if not the only) asset to help employees in retirement. Employers often ignore the very real legal risks of being a trustee of someone else's retirement money. Some seem to miss the risks of offering a 401(k) or other retirement plan, thinking: "We are generous, and we are offering this to our employees at a cost to us and for our employees' benefit" or "Our employees are like family. They know we are doing what's best for them."

While the possibility of an employee suit is very real, the thought of being sued by a beloved employee is often unthinkable to employers. Second, regardless of account size, employees are often tightly and emotionally tied to their balances and demand proper administration of those balances. Third, unlike most U.S. laws, ERISA's fee-shifting provision allows successful plaintiff attorneys to recover fees and costs of litigation. Finally, plan trustees can be personally liable for replenishing plan losses resulting from poor decisions.[3]

3. See, *e.g.*, U.S. Dept. of Labor, Meeting Your Fiduciary Responsibilities, Employee Benefits Security Administration (2012), law.isba.org/3BSROtN ("With these fiduciary responsibilities, there is also potential liability. Fiduciaries who do not follow the basic standards of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan's assets resulting from their actions.").



TAKEAWAYS >>

- The six types of retirement-plan documents outlined in this article help to ensure plan sponsors and plan fiduciaries bear proper responsibility and accountability for an employer's retirement plan, and will communicate developments and benefits of that plan to employees.
- If a plan sponsor does not have each of these six documents or does not have the time or ability to gather them, it is a good indication that it needs help.
- Federal laws require at least a retirement plan with a fiduciary who makes every plan decision in the best interest of plan participants, documents the plan's decision-making processes, understands and periodically evaluates the plan's fees, and hires a fiduciary investment advisor.

Trusted attorneys are in a unique position to help their business-owner clients protect their employees' retirement savings and reduce the plan trustee's personal legal liability for poor plan decisions.

To help, I've developed a list of six document that every plan should have. A plan that has these six documents is generally in good shape. A plan that lacks even one of these documents should seek to improve their plan and reduce their risks.

Six documents every 401(k) plan sponsor needs

Plan sponsors can reduce their legal risk by documenting a plan's fiduciary processes: Documentation is *the* key to protecting plan participants' money and plan trustees.[4] In my years of legal and 401(k) fiduciary experience, every retirement plan governed by ERISA should have in its files:

- Fiduciary acknowledgement of plan trustee
- Fiduciary investment advisor contract
- Internal contribution audit
- Quarterly investment report
- Proof of distribution
- Fee comparison

Fiduciary acknowledgement of plan trustee. "A plan must have at least one fiduciary (a person or an entity) named in the written plan as having control over the plan's operation."[5] The named fiduciary (the "plan trustee"), like all fiduciaries to the plan, must always act solely in the interest of plan participants and carry out their duties prudently.[6]

The Employee Benefits Security Administration of the U.S. Department of Labor put out a concise, 15-page outline of plan fiduciaries' responsibilities.[7] All plan fiduciaries should read this publication and create a "fiduciary acknowledgement" for their files stating that the fiduciary has read and understands the publication. Each fiduciary should sign the acknowledgment. When new fiduciaries are appointed, they should sign one as well.

Without action, this document provides a plan sponsor no legal protection. That said, plan fiduciaries must learn and understand their duties to protect plan assets and themselves. When the governing body charged with enforcement of ERISA puts out readable, digestible guidelines directed toward plan fiduciaries, all plan fiduciaries should read them. I find that fiduciaries who read this publication and sign an acknowledgement become more engaged with the plan and make more thoughtful plan decisions. Significantly, those who understand their duties do not leave those duties to inexperienced human resources staff or office administrators.

Fiduciary investment advisor contract. If a plan hires no fiduciary advisor, the plan trustee (and committee, if one is appointed) retains 100 percent of the responsibility for selecting and monitoring each and every investment in the plan. The liability for poor investment decisions then falls entirely on the plan trustee(s). Accordingly, of the six documents needed in a plan, the fiduciary investment advisor contract may provide the most protection. Failing to find fiduciary language in your advisor contract should prompt the replacement of the advisor.

This assessment should not be difficult, as fiduciaries are typically very clear about their fiduciary duties and want their plan-sponsor clients to recognize the benefits of a fiduciary advisor. The advisor contract simply must *clearly* state that when selecting and monitoring plan investments, the advisor will always act as a fiduciary to the plan participants. If it isn't easy finding fiduciary language in a contract, the plan is likely paying a conflicted salesperson to select funds in their own best interests, rather than the participants'. Paying a conflicted advisor can support a violation of ERISA's "pay only reasonable fees" rule. Having participants pay for a nonfiduciary salesperson can arguably be an inappropriate, avoidable expense.

Advisory contracts can be confusing; plan sponsors often need help deciphering whether their relationship is a fiduciary one. Again, business lawyers can be the best people to find and help correct these types of fiduciary issues. As attorneys, we know that oral and even email assurances that an advisor is a fiduciary doesn't cut it.

A short aside: Beware of selecting investments using an "elite list." Some contracts explain a method of selecting an "elite list" of funds from which a plan sponsor can choose investment options. These lists are often selected less by fiduciary criteria and more by the fund management company being promoted. When selecting funds from such a list, the plan sponsor will likely retain all the fiduciary responsibilities and liabilities related to selecting and monitoring investments, while the funds are not being selected in the best interests of plan participants.

The plan trustee's duty of selecting and monitoring (and replacing) funds is very important. Fund selection and replacement will determine the growth and risk of investments, the costs of investments, how fund fees are shared with other service providers (or not), and other things that directly affect the amount of money employees will have in retirement. In selecting, monitoring, and replacing funds, ERISA *requires a prudent expert standard.* If a plan trustee is not an investment expert, the Department of Labor states that the plan should hire someone who is:

> The duty to act prudently is one of a fiduciary's central responsibilities under ERISA. *It requires expertise in a variety of areas, such as investments. Lacking that expertise, a fiduciary will want to hire someone with that professional knowledge to carry out the investment and other functions.*[8]

Selecting and monitoring funds is a *fiduciary duty*. ERISA requires that each investment be selected in the best

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4. *Id.* at 3 ("[F]iduciaries can limit their liability in certain situations. One way fiduciaries can demonstrate that they have carried out their responsibilities properly is by documenting the processes used to carry out their fiduciary responsibilities.").
5. *Id.* at 1.
6. *Id.* at 2.
7. *Id.*
8. *Id.* at 2 (emphasis added).

interests of plan participants. Hiring a fiduciary advisor is appropriate. An ERISA section 3(21) fiduciary advisor *shares* investment selection responsibility with the plan trustee. An ERISA section 3(38) fiduciary advisor *takes* investment selection responsibility with the plan trustee. In both cases, while responsibility may be shared or delegated to a fiduciary-investment professional, the plan trustee is always responsible for monitoring the plan's service providers (including the investment advisor),[9] and a system should be set up to help with this.

Hiring a nonfiduciary investment "advisor" is perhaps the biggest disconnect between best practices to fulfill ERISA requirements and how plan trustees fulfill their duties. Nonfiduciary "advisors" often maintain and exploit conflicts of interest: They put their own pecuniary interests above the interests of plan participants, which is a clear violation of fiduciary duty. For many reasons—costs being one—a start-up plan will often hire a nonfiduciary investment "advisor." If that happens, no fund selection/monitoring responsibility is shared or transferred; the plan sponsor remains 100 percent responsible and liable for every investment in the plan. In other words, hiring the wrong type of investment professional will typically increase, rather than decrease, a fiduciary's legal risks.

Internal contribution audit. In my experience, the task that most keeps internal plan administrators up at night is coordinating with the payroll company to ensure that contributions go into the plan. Even if the plan recordkeeper/website designer is related to the payroll company, mistakes happen.

The methods of changing an employee's contributions and communicating how that is to be done are essential in avoiding contribution mistakes. Most plans can allow contribution changes to be made via website, by paper form, or both. Changes made online typically generate an email from the third-party administrator to the employer administrator. Administrators often fear that emails will not be noticed, and the requested change missed. Accordingly, plan sponsors sometimes restrict contribution changes to paper forms. Regardless of the method, administrators should have: 1) a solid process of making contribution changes with payroll; and 2) a system for periodically double-checking that correct contributions are being made by payroll and correctly reflected on the website and in account statements by the recordkeeper.

Some plan participants will simply never confirm their contributions or review their own paystubs. Significantly, the Secure 2.0 Act of 2022 now requires plans established after 2022 to:

a) automatically enroll all participants in the plan;
b) contribute 3 to 10 percent of each employee's compensation to the plan; and
c) increase those contributions 1 percent annually to at least 10 percent (but no more than 15 percent) of compensation.[10]

While participants can unwind these contributions within 90 days and opt out of future contributions, plan sponsors may find surprised participants, and even unwilling participants, in the plan. Accordingly, the new requirements emphasize the need to avoid and catch contribution errors.

The solution is an internal audit that compares payroll contributions with the recordkeeper's website contributions. This is relatively easy, but rarely done. Figuring out the correct report needed from each service provider (payroll and recordkeeper) can be as easy as asking your dedicated representatives. Often, the third-party administrator, who is also often the recordkeeper/website designer of smaller plans, will help.

Quarterly investment report. As the Department of Labor states: "Prudence focuses on the process for making fiduciary decisions. Therefore, it is wise to document decisions and the basis for those decisions."[11] Documenting prudent decisions and the basis for those decisions of course extends to the selection and monitoring of plan investments. To that end, best practices dictate that every plan sponsor should receive (or create, if they retain fiduciary responsibility for this) a quarterly report that evaluates, in the best interests of plan participants, each investment option. This report should reflect the criteria used for evaluating each fund and the result of the evaluation. It should discuss when investments are considered for replacement, and when investments are required to be replaced. If the plan is guided by an investment policy statement, the investment selection and monitoring process *must* mirror this statement. A plan's failure to follow its own mandates is a legal risk.

ERISA does not require a crystal ball. ERISA does not find fault in funds that are selected and monitored prudently but perform poorly. That said, if no documentation exists that demonstrates that a prudent process was used, the best process in the world will likely mean little in a dispute. Quarterly reports should be designed to reduce legal risk.

As an added step, plans sometimes require the plan trustee (or investment committee) to sign an acknowledgement that they have reviewed the quarterly monitoring report. This documents that the plan trustee (or committee) is fulfilling their ongoing duty to monitor service providers.

Proof of distribution. Plan sponsors are required to provide certain disclosures to plan participants and those eligible to participate in the plan. Providing these notices often fall to the office administrator or human resources professionals. Notices are legally required and should be addressed with appropriate reverence.

9. *Id.* at 3 ("A fiduciary can also hire a service provider or providers to handle fiduciary functions, setting up the agreement so that the person or entity then assumes liability for functions selected. If an employer appoints an investment manager that is a bank, insurance company, or registered investment adviser, the employer is responsible for the selection of the manager but is not liable for the individual investment decisions of that manager. However, an employer is required to monitor the manager periodically to assure that it is handling the plan's investments prudently and in accordance with the appointment.").
10. SECURE 2.0 Act of 2022.
11. U.S. Dept. of Labor, *supra* note 3, at 2.

Many 401(k) claims stem from an alleged failure to provide notice of a right under the plan. For example, one disgruntled former employee sued his former employer alleging that he (the employee) never received notice that if he contributed 3 percent of his salary to his 401(k) plan, the employer would match that contribution. The damages sought were six years of 3 percent of his salary plus the gains that an appropriate investment would have earned in the market.

Unfortunately, the employer had no records that the employee received the annual notice alerting him of the contribution match. While employer depositions supported that the employee did indeed receive annual notices and even participated in most of the annual participant meetings in which he was told of this match, the employee's deposition disputed this. Accordingly, a case that should never have been brought settled for tens of thousands of dollars. ERISA's fee-shifting provision was likely a big driver in this litigation.

Documentation created in real time demonstrating that the employee received annual notices and attended annual participant meetings could have avoided litigation. Accordingly, those providing notices are encouraged to create a method of documenting notices and attendance. For notices, a signed certificate or document listing the notice provided, the method of distribution, the recipients, and the date(s) of distribution should be created. Or if email distribution is used, retaining the emailed notice is key. Attendance lists signed by attendees are a good way to document annual meeting attendance (a list of content reviewed in the meeting is essential, too). Even a contemporaneous list of attendees is more helpful than nothing. The bottom line is that notices are important, as is documenting the distribution of notices.

Recent fee comparison. "While the law does not specify a permissible level of fees, it does require that fees charged to a plan be 'reasonable.' After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable."[12] In other words, a plan sponsor breaches its fiduciary duty when a participant overpays for services. Accordingly, plan sponsors must confirm that participants are not overpaying for any particular service. Plan sponsors have three popular methods to assess fees: benchmarking, request for information (RFI), and request for proposal (RFP).

Benchmarking services are the easiest way to gather comparative fee information. Advisors and third-party administrators often pay for or have access to third-party databases that group plans together based on similar industry, asset size, and number of employees. The database then analyzes the fees of the group and displays those fees in understandable ways, like average advisor fees or averaging fees over quartiles. Current plan fees can then be compared with the average fees of the database group or to each quartile of fees. Plan sponsors can compare total fees as well as each separate fee (*e.g.*, advisor fee, third-party administrator fee, recordkeeping fee, custodian fee, investment fund fee, etc.).

Benchmarking's biggest limitation is lumping all service providers together in the same group. For example, the services included in one third-party administrator's fee may be excluded from another. Similarly, comparing a nonfiduciary advisor fee to a fiduciary advisor fee may make little sense, but such differences are not typically broken out by benchmarking services. That said, benchmarking can be an effective way of comparing a plan's costs with similar plans and determining whether a plan or its participants may be overpaying.

To obtain a bid for a particular plan with particular services requires an RFP or RFI. An RFP typically involves a full-blown, formal request of outside service providers to bid to provide services to a plan. The proposals typically include all the documents needed to start a relationship, including due-diligence support and all necessary contracts. It takes time to outline the services needed; prepare the RFP; find appropriate recipients; and distribute, review, and compare bids.

Smaller businesses typically lack the resources to request and review RFPs. One solution is to use an RFI, a stripped-down version of the RFP. RFIs are streamlined bids without all the legal support and contracts. RFIs can break out services and costs and can be compared line-by-line with current services and costs. That said, obtaining RFIs can be cumbersome. Advisors that break out services and costs for comparison can be helpful.

Organizing all fees into a spreadsheet that allows side-by-side comparisons is key. Spreadsheets should include the following line items at a minimum:

- ERISA fiduciary advisor (or nonfiduciary advisor);
- third-party administrator;
- recordkeeper/website;
- custodian; and
- investments (fund fees).

The total fees can then be broken out into:

- paid by plan sponsor; and
- paid by plan participants.

Once this template is set up, comparing current fees with an RFI or a benchmark is easy. The spreadsheet also highlights whether a nonfiduciary advisor should be replaced with a fiduciary advisor. It is a difficult legal argument that payments to a nonfiduciary advisor who has no duty to select funds in the best interest of plan participants is a prudent decision. Those same funds would likely cover (or come close to covering) the cost of a fiduciary advisor who acts in the participants' best interests.

Industry thoughts seem to indicate that big plans should analyze fees annually, and smaller plans should wait no longer than three or five years to compare costs.

Obtaining documents

Every plan sponsor should know what the plan pays for each service provider and whether their advisor is a fiduciary. However, despite required fee disclosures

12. *Id.* at 5.

to the plan sponsor and participants, that information is often as easy to find as a needle in a haystack. One advisor contract I recently reviewed had a range of 0 to .75 percent as an advisor fee, which was laughably unhelpful. Fees can be found in original contracts, disclosures, email-agreement updates, etc. It is cumbersome to find the data.

How can a plan sponsor get this data? Ask. It's that simple. Plan sponsors should ask their service providers how much they charge and to forward the document that shows that cost. Plan sponsors should demand their advisors point to the fiduciary language in the advisor contract. Plan sponsors are required to understand all plan fees and needn't worry about bothering their service providers. If service providers aren't forthcoming with the information, replace them. There are plenty of helpful, upfront servicers out there.

Attorneys can help

Because obtaining fee information can be a hurdle, attorneys can help. The benefit to the business owner (reducing legal risks) is huge, and the benefit to the attorney is a stronger business relationship.

Operating a retirement plan within ERISA is not easy, and smaller plans often have little guidance through the ERISA minefield. Trusted business attorneys can help plan sponsors stay out of trouble. IBJ