Four Questions
to ask of your retirement plan

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A confluence of events has brought increased scrutiny to employer retirement plans that should certainly result in *change.* First, all are familiar with the impact of the "boomer" population and their expected life span. Second, there is an onslaught of litigation revolving around the management of employer retirement plans. Third, the public is becoming increasingly aware that most of those in the financial services industry have *no* legal or regulatory obligation to "put the client's interests first" or to "disclose conflicts of interest". It comes as a surprise to many that the typical "financial advisor", "financial planner", "wealth manager", et al, at banks, wirehouses, broker/dealers, insurance companies, etc, are nothing but "salesmen" who are only obligated to themselves and their firms – however good their intentions.

With so much litigation pending in this area (google "401k" or "403b lawsuits"!), it is impossible to come to any conclusions regarding just what the employer is going to have to do to meet his fiduciary responsibilities. However, the conviction should be forming in the minds of those responsible for employer retirement plans that they should be asking some questions. This is well and good. The same road should both avoid litigation and improve the retirement income security of the plan participants. Embrace the process!

Question One: Is there a process in place to manage the plan that is written, current, properly executed, and consistent with the "Prudent Man" rule? In other words, is the retirement plan managed as well as your business and with the same care?

1. Is there an investment committee?
2. Is there an Investment Policy Statement?
3. Are activities related to the plan monitored and documented?
4. Is there a system of checks and balances?
5. Is there a written "Quality Control" procedure?
6. Are there standards by which the success of the plan is measured?
7. Is there accountability and periodic review?
8. Is there cost control and is it known where the money is going?
9. Has anyone in the process accepted fiduciary responsibility *in writing*?
10. Has anyone in the process submitted a written Code of Ethics?
11. Are "conflicts of interest" disclosed, explored, and documented?
12. Can you, as the sponsor of the plan, stand behind your company retirement plan with the same confidence with which you stand behind your product?

Question Two: Are the plan assets used *solely* for the benefit of the participants and their beneficiaries?

1. Are the plan assets used unnecessarily and needlessly for the benefit of the financial firms involved in the plan? Are costs justified?
2. Is the plan associated with any kind of personal relationship-friend, neighbor, relative, your financial advisor, etc. (Put a "Sue Me" sign on your back.)
3. Has the plan been used as a bargaining chip with a bank to secure "free checking", better loan terms, or some such benefit for the company?
4. Has the plan been used as a bargaining chip to obtain a benefit for the firm from a payroll company?
5. Does the firm, school district, etc, accept gifts/benefits from the provider that could instead be used to lower the costs of the plan?
6. Has the plan been used as a bargaining chip with an insurance company or any supplier for some other benefit to the firm that is unrelated to the plan?
7. Do the plan fiduciaries allow the provider to use plan assets to open accounts or to sell its funds or other investment choices?
8. Is your employee information secure or could it be shared with unscrupulous salesmen who provide referral fees?

The financial firms involved in the plan cannot be blamed for doing the best for their firms. It is their *job* to maximize sales and profits. An inexpensive fund with a high expense ratio is good for the fund company. It is a "high margin" product just like some of the products that your company sells. Your bank can't be blamed for maximizing revenue by offering lower loan rates to your firm in exchange for receiving your 401k. Your liability insurance provider can't be blamed for foregoing a rate increase in exchange for the company retirement plan. Their duty is to their *own* firms.

Surely, though, these "benefits" are not free. Certainly, what is lost in checking fees, insurance rates, loan rates, or other benefits is going to be made up in revenue from the retirement plan assets. Is this not using plan assets for something other that the *sole benefit of the plan participants?*

Consider this scenario: Your plan provider offers to relieve your Human Resources department of some administrative duties. They will take over contact with employees when they want to take assets out of the plan due to retirement, in-service distributions, or separation from service. In exchange for relieving your HR department of this burden, they use the contact with your employees to open accounts, gather assets and sell their funds. Those manning the telephones are trained to keep assets in the fund company by discouraging withdrawals or selling their own IRA's. Withdrawal forms and withdrawal procedures are revised to make it easy to stay with your provider and difficult to take the money elsewhere. *Is this not the use of plan assets by the provider for purposes other than the sole benefit of the plan participants?* Does not the employer profit by having the provider take over some administrative duties and thereby also use the plan assets for something other than the sole interests of the plan participants? Certainly, these providers give the impression that they are spending more time and effort gathering assets and selling their funds than they are on the plan itself.

Question Three: Are the investment choices prudent?

1. Who chose the investment options and where is their interest? For example, were they chosen by the financial firm with the duty of maximizing income for his company or were they chosen by the employer with the duty of maximizing return for his employees?
2. Is there "revenue sharing" between the financial firms? Where and how much?
3. Can each investment option be classified as "prudent" selection?
4. Are there special "Retirement Class" fund shares with lower returns and higher expenses? Is this necessary? Where does the money go?
5. Are there "special relationships" between the provider and some fund company included in the plan? Why and to whose benefit? Is revenue sharing(kickbacks) involved?
6. Who gets the 12b-1 fees? Are they different for different choices?
7. Are there "finder's fees" on new money? Who gets it? Who pays it?
8. What *are* the proper criteria for choosing funds or subaccounts?
9. Do the participants, who provide all the money and take all the risk, get the majority of the return?
10. Are the investment options actively managed funds or passive index funds?
11. Are there asset allocation funds among the options (by whatever name they use)? Just what is *in* these funds?
12. Could the fund choices be put in a good asset allocation that would offer the participants a solid historical return?
13. What is the overall return of the plan after *all* expenses?
14. How much of the investment return goes to the participants and how much goes to the financial firms involved?
15. If the plan provider chooses the investment options, is there any reason to expect that he would choose a better option for the participants rather than a more profitable one for his firm? Has he accepted fiduciary responsibility in writing?

This is a very interesting area and the one that provides the grist for most litigation, especially in the area of plan expenses. For example, consider the issue of actively managed funds vs. index funds. Actively managed funds tend to have high expenses and high trading costs while index fund have low expenses and low trading costs. Yet, only a fraction of actively managed funds beat the index in any given year and few (if any) of those funds make their way into retirement plans. Does this not give one the impression that *no* actively managed fund is a "prudent investment choice"?

While there are many funds available elsewhere that might very well be better choices than an index fund, are there any in your plan that *are* so? Is there *any* reason to believe that the investment options in your plan might *possibly* carry the expectation that they might beat their respective index? So, then, are the plan assets used to pay higher expense ratios and trading costs in order to pay a million dollars a year to the fund

manager who shares revenue with other financial firms in the chain - and all of this to the detriment of the plan participants? Even worse, are any of the actively managed funds in your plan actually "shadow index funds" that are almost indistinguishable from index funds except for a high expense ratio?

Some suspect that "asset allocation funds" should be added to politics and sausage as something that one doesn't want to watch being made. Further, having been put together, the parts are no longer distinguishable. Now, considering that the financial firms associated with the plan are charged with maximizing income for their firms, just how would we come up with such a fund? One would expect that the fund would be a "fund of funds". Why go to the expense of a separate fund when one could just blend existing ones? Second, why not use a blend of funds that are high-margin? Why not make more money rather that less? Third, should we not use funds that give us the most in "soft dollars – the dollars that are hidden? Is it any wonder that most asset allocation funds usually have low returns? Is it any wonder that fund companies have been drooling over QDIAs? If a single fund has hidden costs, what of a "fund of funds"?

Question Four: Does the plan provide retirement income security for our employees?

1. Are the participants getting good returns on a risk–adjusted basis?
2. Do the participants get meaningful education regarding financial planning and *is this education driving higher participation rates and higher contribution levels?*
3. Is the education provided independent and unbiased?
4. Have we aligned the goals of the plan providers with the goals of the participants?
5. Have we demanded that those profiting by the plan take fiduciary responsibility in writing?
6. Are the participants happy with the plan?

Shortcomings in the management of retirement plans seem to follow the path of failure to execute– "failure to monitor", "failure to inform"," failure to inform ourselves", "failure to establish", etc. Part of the problem is, no doubt, simply a lack of understanding of fund structure on the part of those responsible for the plan. Second, many plans are probably only there because "we have to have one". True enough. It *is* expected. Finally, a company retirement plan seems easy to ignore in the rush and crush of business.

However, it would seem that today, while it is still necessary for an employer to offer a means of putting away retirement money on a tax-deferred basis, these plans can only be ignored at serious peril. But then, is not the retirement income security of one's employees something that should be taken seriously? Is it not important for a firm to meet its fiduciary duties in this area? Would not it be a real plus to let the company employees know that these duties are being met and that their retirement is important to the firm? It would seem that doing so would serve three purposes. First, the benefit to

employees could be greatly expanded and this is a part of overall compensation. It can be a key to obtaining and retaining employees. Second, no one wants to lose a lawsuit. Third, no one wants to *have* a lawsuit. In today's climate, the "If you can't trust a Wall Street firm or an insurance company, who can you trust? defense" is probably not going to cut it.

Instead, why not make it the company's business to investigate its retirement plan, to do everything possible to make it serve the participants, and to set up an ongoing process to monitor the plan that will ensure continued performance? Demand that all costs be disclosed, that all conflicts of interest be documented, obtain impartial financial advice for the participants by someone with the qualifications to do so, and take the retirement income security of your employees to heart. Make it your business not to just offer a retirement plan, but to make it successful for the participants. Make the retirement of your employees a "joint venture".

Educate yourself, the plan investment committee, and your employees. Your firm knows that education is critical to job performance and many firms encourage and reimburse employees who seek more education. Studies consistently show that most investors are "financially illiterate". Is it not in the interests of your firm to encourage acumen in the areas of investing, retirement planning, and comprehensive financial planning?

Take advantage of the three "Safe Harbors" available. Make it clear to the providers that your focus is the retirement income security of your employees and they must immediately stop using your plan to further their own objectives. After all, when they were dying to sell you the plan, they did not tell you that they would be using it to sell their own IRA's, mutual funds, and annuities. Remove any tinge of self-serving behavior on the part of any party to the plan. Insist that they act as fiduciaries and **disclose any conflicts of interest** and **put the client's interests first**. *Make it clear to your employees that their retirement income security is too important to allow anything but full attention to the success of their retirement.* Embrace this retirement plan model, and demand that those being paid by the plan embrace it as well!

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