So You Finally Created a Retirement Plan: A Primer on Your New Responsibilities

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Introduction

In recent years, many legal services programs have belatedly created retirement plans for their employees. In doing so, we have recognized that many of our colleagues have devoted their careers to serving our clients, and we have a collective duty to help assure them at least a minimal level of financial security in their old age. The existence of a retirement plan, or the lack of one, can also be a factor in recruiting new and mid-level staff.

While our goals are laudable, this expansion of our responsibilities plunges us into another elaborate regulatory and financial world. The purpose of this article is to highlight some of the broad issues and potential pitfalls inherent in operating a retirement plan.[1] In doing so, I speak from the perspective of an executive director who initially thought that after the plan was created I could rely on our provider to run it without much involvement from me. I now know differently, fortunately without anyone in our program having had to endure any unhappy consequences.

In our program we proudly created a retirement plan in 1998, consisting of a 401(a) plan to which our organization contributes 5% of every employee's salary and a companion 403(b) plan to which employees can make voluntary contributions (which are not matched by our organization). However, we delegated virtually all of the responsibility for managing this plan to the large national pension organization which helped us set it up. After several years we became dissatisfied with that firm because of poor communication and because our staff was not getting sufficient advice about how to choose investments within the range offered to them. So we embarked on a search for a new provider, and in the process, educated ourselves about the breadth of our own responsibilities to continuously monitor the operation of our retirement plan. This article will set out in simple and practical terms what we learned that we must do to fulfill the commitment we made to our staff to help them prepare for retirement.

Welcome to the World of ERISA — Get Expert Help Immediately!

The basic framework for retirement plans was created by the Employment Retirement Income Security Act (ERISA) of 1974 and the regulations and case law that have sprung from it. With this enormous body of law in mind, the first and most important step you should take is to find a pension law expert to advise you. A lawyer on your board or one of their partners may practice in this area, and many larger firms have committees to oversee their own retirement plans. While legal services program directors pride themselves on being quick studies, this is an extremely complex area of the law, as to which expert advice is indispensable.

When you created a retirement plan you created a number of documents, including a basic Plan Document that spells out the rules for your plan including eligibility, funding, etc.[2] In this Plan Document, one or more people must be designated as trustees for the plan. Notwithstanding that an organization's executive director may be a plan beneficiary, it is very common, and considered appropriate, for the executive director to become the sole trustee of the plan. As the plan trustee, the executive director becomes a fiduciary under ERISA. Even if you are not a trustee or the sole trustee, as a manager of your program, in all likelihood you will have some management role over the retirement plan. Therefore, as your program's executive director, your fiduciary responsibility is inescapable.

It makes sense to set up a committee to help manage the retirement system. Such a committee can include both staff and board. Your program's board of directors also bears fiduciary responsibility for the plan and they should play an active role in its oversight. Finally, the brokers or investment advisors, and the officers of the organization that you hire to manage or operate your plan also assume important fiduciary responsibilities. Anyone who has discretionary authority over plan investments and/or exercises any control over plan assets or gives investment advice for compensation is an investment fiduciary under ERISA.

ERISA, at section 404(a), imposes a high standard on investment fiduciaries, the "prudent expert" rule. This requires that investments be selected "…with the care, skill, prudence, and diligence…that a prudent man 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…" The standard is not that of a prudent lay person but rather that of a prudent fiduciary with experience in dealing with such an enterprise. And courts have held that the size of a plan is irrelevant to a determination about the prudence of a fiduciary's conduct, so that even though our legal services retirement plans are relatively small, the duty is the same.

Your New Role as a Fiduciary — A Few Specifics

First of all, as a fiduciary you must act according to the plan documents. That is why expert advice is needed when these documents are prepared. Amending them can be complicated, so you and your pension law expert need to take the time necessary to make sure that they are fair, complete, and appropriate for your program, while giving you as much flexibility as possible. Once the plan document is in place, the trustee must follow it.

Second, the trustee must act exclusively for the benefit of the plan participants and their beneficiaries. The trustee should not use plan assets for the trustee's own gain or the program's other financial needs, or allow anyone else to use the assets improperly.

Third, in exercising the heightened duty of a prudent fiduciary, it is vital that you engage expert help in selecting and monitoring investments and investment advisors. Finding a reliable and approachable investment advisor is not easy, but the trustee must exercise care in doing so, by interviewing and evaluating several possible providers, talking to references, and finding out how successful a would-be advisor has been in the past.

Diversifying Plan Investments and Developing an Investment Policy

An important component of the responsibility of any prudent fiduciary is to diversify plan investments in order to minimize the risk of large losses if any one investment turns into a disaster. The plan should be built on investments with a range of risks and varying emphasis on short-term or long-term returns. Although not specifically required by ERISA, it makes sense to develop a written investment policy statement which can include a discussion of the plan's approach to the investment diversification issue. This policy statement provides guidance to the fiduciaries about how to invest funds, and it also communicates to the plan participants how the fiduciaries intend to approach this responsibility.

Such an investment policy statement should include a general mission statement about the plan's investment purposes and goals. The goal of a legal services retirement plan would be to provide a vehicle to build resources for plan participants for their retirement. The plan should go on to describe in some detail the approach to be taken in selecting, monitoring and evaluating plan investments. If there is an investment committee, its composition and responsibility should be spelled out.

The investment policy should include a procedure for selecting and evaluating investment advisors. The policy should require a regular review of the plan's investment choices, at least on an annual basis, to assess performance and consider replacing plan investments and/or plan advisors.

Drafting such an investment policy statement is another task for which it makes sense to rely on experts. However, as a trustee/ fiduciary, the executive director should fully understand the investment policy and the provisions for reviewing the choices made pursuant to the policy.

Providing Staff with Appropriate Investment Advice: Recognizing that Legal Services Staff are Smart People but Novice Investors

In some retirement plans, the trustees make all the investment decisions, but it is likely that in most legal services plans participants are given a choice about how their share of the funds is invested, within the range of alternatives selected by the plan. In setting up such a set of choices, the trustee must assure that each investment option is prudent and will be monitored appropriately. However, it is also vital that the options, when considered as a group, must provide a broad range of choices. Finally, the options and the services to be provided to participants under the plan must be suitable and appropriate for the participants. While many people in legal services are highly intelligent, in most of our programs there are only a few employees who are sophisticated investors. The great majority of our employees may have little or no experience or knowledge about investment choices. As part of the plan administration, these participants must be given access to advice that is appropriate for them.

How Many Investment Choices to Offer and How to Monitor Them

In choosing the range of investments, legal services managers will obviously have to rely on investment experts. So, again, the choice of investment advisors and plan managers is critical. The trustee must have a basis for concluding that the advisors have both independence and expertise about investment choices. And the trustee must be assured that the investment choices to be offered have been thoroughly evaluated and are financially sound.

Generally speaking, it is important to provide a range of investment choices, but not so many that the decision making becomes impossible for unsophisticated investors. A choice among twelve or so funds of varying natures and levels of risk is optimal. Too many choices will leave employees overwhelmed, while too small a menu works against the diversification that can minimize risk. Because younger employees may make very different choices than staff members who are approaching retirement age, choices suitable for all of these employees should be available.

Whether through an investment committee or plan or solely by the trustee, the performance of chosen investments must be monitored. With appropriate expert advice it is easy to obtain information that compares the performance of any investment to "benchmarks" for similar investments. Investment funds whose performance lags behind their peers should be carefully re-examined. No investment policy can prevent some losses in a declining market, but the losses should not be disproportionate. An investment policy that so states, and a regular review of investment choices, will together go a long way toward meeting the plan's fiduciary responsibilities.

It is possible to work with a financial services organization that offers complete retirement plan services, including investment guidance and administration of the plan, which encompasses reporting to the participants, the mandatory filings with the Internal Revenue Service, and the plan testing and monitoring required by law. It is also possible to split these responsibilities, having a Third Party Administrator (TPA) manage the reporting requirements and other administrative duties, while a brokerage firm helps select the investments and advises individual participants about how to make choices among the alternatives. At New Hampshire Legal Assistance we considered both models. When talking to partnerships of TPAs and investment advisors, we wanted to be satisfied that both sides of the partnership would perform appropriately, so we checked references and held extensive interviews.

Keep Talking with the Staff

In evaluating providers and advisors, an important criterion for us was their ability to communicate and build trust with staff members of greatly varying financial literacy. We looked for financial advisors who had expertise but also had an approachable style, who were easily accessible, and who could give an employee both appropriate information and a sense of individual control and direction.

As noted above, we changed providers because our first provider was not accessible and was not giving our staff sufficient individual attention and guidance. Whether or not the executive director is the trustee, the executive director should regularly check with staff at all levels to find out how the plan is working from their perspective and to learn how they feel about the advisors and administrators.

A Summary

1. Get expert advice all the way.
2. Take your fiduciary role seriously.
3. Ask lots of questions of providers and experts.
4. Provide a range of, but not unlimited, investment options.
5. Give the staff the education and information they need to make the best individual choices among these options.
6. Be explicit about investment philosophy through a written plan.
7. Regularly evaluate each investment option.

1 This article is not intended to be a detailed road map for setting up such a plan or an outline of the legal requirement for such plans.

2 While your Plan Document was undoubtedly drafted by someone who has kept up with this area of the law and is familiar with both the legal requirements and practical issues of operating a plan, this does not mean that you should not ask basic questions and seek explanations of provisions you don't understand.