ROCHESTER BUSINESS JOURNAL
RBJ
VOLUME 31, NUMBER 13 WWW.RBJDAILY.COM JUNE 26, 2015

Retirement plans don't have to cause headaches

Many organizations view retirement plans as a necessary evil.

These plans may help attract and retain talent, but they can also be expensive, time consuming, and difficult to monitor and administer. As a result, corporate retirement plans are often ignored by those who oversee them.

Business owners generally serve as their own plan trustee, and are ultimately responsible for the proper administration and maintenance of the plan. But many of them are unaware of the responsibility and significance of this role. So it is not unusual for the plan trustee to retain a golfing buddy or a brother-in-law to provide services to the plan. Unfortunately, this typically ends up with arrangements that are not always in the best interests of plan participants, and can ultimately create headaches or financial liability for business owners.

Even worse, the retirement plan industry is rife with abuse. Brokerage firms, banks, insurance companies and investment advisors have all jumped on the retirement plan bandwagon. Selling products that are both complicated and expensive appears to be the norm, particularly for plans of smaller size.

This combination of benign neglect by plan trustees and shenanigans by service providers often leads to plans with high costs and poor investment performance. This of course hampers the ability of plan participants to adequately fund their retirements.

The Department of Labor has taken notice and has stepped up its oversight. It is not hard to find detailed information on trustees' fiduciary responsibilities at the Department of Labor website. However, at a minimum, trustees need to act prudently, put participants' interests first, offer a diversified menu of investment funds and make sure the plan has reasonable costs.

Recently there have been a number of high-profile lawsuits where employees have sued their employers for providing subpar plans. For instance, the Supreme Court ruled on a case last month that was

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brought against Edison International for its alleged mismanagement of its 401(k) plan. The outcome was a clear message that fiduciaries have an ongoing responsibility to ensure plans are set up appropriately and managed through time in the best interests of the plan's participants.

Other cases include suits brought by employees of Fidelity Investments, Fifth Third Bancorp, MassMutual Life Insurance and John Hancock. Interestingly, all these companies are vendors to 401(k) plans, and presumably know the issues faced by retirement-plan fiduciaries in intimate detail. The fact that the plans they provide for their own employees were so bad that these firms were sued, successfully in some cases, illustrates the dysfunction in the retirement plan market.

Retirement plans are highly regulated, and clearly there are many pitfalls for plan trustees. The most important thing is that plans must be managed with plan participants in mind. This money belongs to the participants; it is not a corporate asset. All decisions regarding these plans can boil down to a simple test: Does it benefit the participants or not?

There are some simple steps trustees can take to help ensure they offer participants an honest plan that is in compliance with Department of Labor regulations.

Too often, expensive mutual funds find their way into these plans, as their hefty fees are used as kickbacks to offer additional compensation to brokers and administrators. Using index funds can significantly reduce investment costs. Also, index funds, by definition, match the returns of the market, avoiding negative performance surprises. This can help mitigate the odds of an employee lawsuit, while potentially saving money for both participants and the sponsor.

Some trustees don't like index funds, preferring actively-managed funds because of their potential to "beat the market." While that is a valid philosophy, I believe those funds are better suited for personal portfolios, where trustees won't be held liable if significant underperformance results.

Target date funds are another good idea. These are usually mutual funds that hold a mix of other mutual funds, diversifying across stocks, bonds, and cash. They start with more aggressive allocations, but automatically become more conservative as participants age. These funds offer a simple, one-stop shop for participants not wanting to take the time to build their own portfolios. Target date funds using index funds are the best option because of their combination of simplicity, low cost and strong performance potential.

Removing overly risky investment funds from the lineup is another important protection. It is not unusual to see retirement plans with high-yield or "junk" bond funds, emerging market funds, commodity funds and others. While these asset classes can play a role in a diversified portfolio, unsophisticated plan participants may overly concentrate in these funds at the wrong time, and ultimately lose a lot of money. Using broadly diversified, higher-quality stock and bond funds is a more prudent approach.

Documentation and review are essential components to any retirement plan. Ideally, plan sponsors would appoint a retirement committee to regularly review the plan structure, investment performance, and the efficacy of the plan's service providers. This may involve writing an investment policy statement, ensuring the plan's investment adviser provides regular performance updates, and conducting periodic request for proposals to ensure the plan is getting the best service for the best price on an ongoing basis.

Finally, regular participant education

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should be offered. Most retirement plan participants are not savvy investors. Investment advisers to the plan usually offer participant education as part of their service package. It is important to regularly schedule these meetings so participants can get the information they need. It is also helpful to document that education was provided in case regulators come knocking.

While many plan sponsors take a head-in-the-sand approach to plan administration, there is a more effective way. It is possible to offer a common-sense plan that meets employees' retirement-saving needs and trustees' fiduciary responsibility. Though retirement plans can become complicated, the process for establishing and maintaining plans should be kept relatively simple and cost effective. Some effort and attention is needed, however, to ensure compliance with regulations and that the participants are getting a fair deal with their retirement dollars.

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