Risk Management for Retirement Plan Sponsors

Highlights

What is a Plan Fiduciary?

An employer who acts as a plan sponsor with responsibility for handling, directing and investing employee contributions is a retirement plan fiduciary.

Fiduciary duties for plan sponsor include:

- Managing the plan with only the interests of participants and their beneficiaries in mind
- Keeping plan expenses to a reasonable level
- Following the terms of the plan's governing documents
- Ensuring the plan's investments are diversified
- Doing all of this with "care, skill, prudence, and diligence"

Learn More.

If your business offers or plans to offer a qualified retirement plan, you should review ERISA's plan requirements on the Department of Labor website. For 401(k) plans, you can download a copy of "Meeting Your Fiduciary Responsibilities" from the same website.

www.dol.gov/general/topic/retirement/planinformation

Many small business owners who offer qualified retirement plans to their employees don't realize that, as the plan sponsor, they are also the plan fiduciary, which means they're accountable if anything goes wrong. In this issue we'll detail what it means to be a plan fiduciary and outline what a small business can do to protect against the risks involved in plan sponsorship.

As small businesses continue to thrive in a growing economy, many business owners are being advised by their accountants and financial advisors to take advantage of the tax benefits available through qualified retirement plans. As of 2018, nearly 50 percent of small- to medium-sized businesses offer some type of qualified retirement plan. While all types of qualified plans are subject to ERISA (Employee Retirement Income Security Act) guidelines, not all plans are subject to strict fiduciary requirements.

An Example: Maria's Floral Shop

For nearly 10 years, Maria has owned and run a bustling floral shop, now employing 15 people – five full-time and 9 part-time. Her accountant recommended that she establish a qualified retirement plan so she could take advantage of a current tax deduction for contributions to the plan while accumulating tax-deferred earnings for her retirement. Seven of her employees are eligible to join the plan so she decided to establish a SIMPLE-IRA, which is the easiest to administer – almost a set-it-and-forget process whereby each employee sets up their own individual retirement account and she directs a portion of their salary to their plan.

Is Maria a plan fiduciary subject to personal and business liability should something go wrong with the plan? If so, how can she protect herself against liability?

Are You a Plan Fiduciary?

For businesses with fewer than 100 employees, the Simplified Employee Pension (SEP) IRA and the Savings Incentive Match for Employees (SIMPLE)

IRA are the most popular plans for their lower costs and ease of administration. With these plans, employees invest in their own IRAs and employers provide a matching contribution. (Only employer contributions are allowed with a SEP IRA; employers are required to match employee contributions up to 3% of earnings to a SIMPLE IRA). Because plan sponsors of IRA-based plans don't handle, direct, or invest plan assets on behalf of their employees, they are not subject to fiduciary requirements.

Businesses of any size can also choose a 401(k) plan; however, because it requires third-party administration the costs can be higher and the reporting requirements can be more complex, making it more suitable for larger companies with the staff to manage it. And, since plan sponsors of 401(k) plans do handle, direct, and invest funds on behalf of their employees, they along with any investment advisor they might use are full-fledged fiduciaries subject to personal and business liability.

Protection for Non-Fiduciary Plan Sponsors: ERISA Fidelity Bond

Although plan sponsors of SEP and SIMPLE IRAs generally don't handle, direct or invest plan assets on behalf of their employees, there is a moment when the funds are supposed to leave the business's assets to be placed in the employees' IRAs that the plan sponsor has some liability. If for whatever reason the funds don't make it to the employees' accounts as expected, the business's assets are considered "plan assets" subject to fiduciary rules.

For that reason, ERISA requires SEP and SIMPLE IRA plan sponsors to purchase an ERISA fidelity bond. An ERISA fidelity bond is a type of insurance that protects the plan against losses caused by acts of fraud or dishonesty.

Protection for Fiduciary Plan Sponsors: Fiduciary Liability Insurance

Although it is not required by ERISA, plan fiduciaries should purchase fiduciary liability insurance, which is the only coverage that can protect both the plan sponsor and the business against fiduciary-related claims. The policy provides coverage for legal expenses and any financial losses experienced by the plan due to a breach of fiduciary duty, such as:

- providing poor investment practices
- failure to offer appropriate investment options
- charging unreasonable fees
- inadequate plan communication
- a lack of guidance and educational services
- or any action deemed not to be in the best interest of the plan participants

Bringing it Back Together: What Should Maria Do?

Because her business offers an IRA-based plan, Maria doesn't meet the criteria for fiduciary responsibilities. However, she is required to comply with ERISA guidelines for sponsoring a qualified retirement plan, which includes purchasing an ERISA fidelity bond.

Should she ever convert her SIMPLE-IRA to a 401(k) plan, she would be considered a plan fiduciary with liability exposure. At that time, she could purchase fiduciary liability insurance to protect her and her business's assets against fiduciary-related claims.

*Application and credit approval required.

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