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HOW 401K PLAN SPONSOR FIDUCIARY LIABILITY CHANGES WHEN RETAINING RETIREE ASSETS

By: Christopher Carosa - May 18, 2021

A few years ago, it was obvious to 401k plan sponsors and fiduciary advisers that keeping ex-employee assets in the former company's retirement plan was a risk not worth taking (see "Ex-Employees Who Don't Rollover – Will 401k Fees Increase Plan Sponsor Liability?" FiduciaryNews.com, June 28, 2011).

Today, however, this wisdom is less obvious. In fact, there's a growing belief that it's in the best interest of retirees to keep their assets with the company they used to work for.

"As these funds will still be in an ERISA plan," says Arvind Ven, CEO of Capital V Group in Cupertino, California, "making sure that the plans are evaluated every year, expense ratios are in line with industry averages, third party testing of the plan, having an IPS are all important aspects."

Others simply refuse to concede it's even an issue.

"The majority of employees take all their money out of their 401k plans via rollover as soon as they retire," says James O'Donoghue, Financial Advisor at BCG Securities in Cherry Hill, New Jersey. "401k administrators charge typically \$100-\$150 for every distribution, it is not prudent to leave the money in that account as a retiree."

Still, many retirement plan service providers understand the pressure there is for plans to retain retiree assets. The only question is to what extent this has an impact on fiduciary liability.

"With the rising trend of plan sponsors actively seeking to maintain retired employees' assets in a plan, this also means that post-retirement financial activities will now be in the purview of the plan sponsors in a much more constant way than they had been before," says Syed Nishat, Partner at Wall Street Alliance Group in New York City. "Rather than the funds rolling over into IRAs away from the plan and from there becoming retiree distributions, it becomes the responsibility of the plan sponsors to facilitate distributions as these retired investors require income. To serve this updated model of the plan as more than a savings vehicle, where it is being promoted as something to generate income to those who have left their assets in the plan post-retirement, plan sponsors are acting in a direct manner between the savers and their retirement goals, meaning they are held to the fiduciary standard in terms of keeping an eye on performance and fees not only for those in the savings phase of the plan, but also those who have entered the phase of requiring retirement income, with some plans even expanding their offerings to include a retirement tier that operates on that fiduciary level."

It's clear the needs of asset accumulators (those saving for retirement) are different than the needs of asset decumulators (those spending in retirement). This may create a bit of a "split-interest trust" scenario for plan sponsors. Unlike personal trusts that have split interests, retirement trusts, particularly 401k plans, are designed to accommodate split interests among the various beneficiaries they serve. That doesn't mean, though, this doing so is not without risk.

"Retirees need investment options that actually fit their lifestyle," says Michael Windle, Owner and Financial Advisor at Custom Wealth Solutions in Plymouth, Michigan. "Most times you have mutual funds that are mostly equity-driven and a couple of bond funds (essentially still market-driven) that are still fairly high risk. If you want any level of safety you have to move to cash which earns next to nothing and isn't a good option either. If you choose a target or retirement fund, it is very difficult to get a good grasp on how that is actually invested (for reducing safety, or returns). Retaining assets after an employee retires means offering options that fit their new needs."

Not only do things get dicey, but they also get complicated. By now, it's fairly straightforward what plan sponsors must do to help encourage retirement savings. This is because there's not a lot of strategies to choose from. Once a person enters retirement, the number of scenarios proliferate. Unless the plan sponsor is a financial professional, it's going to be a challenge to quickly comprehend all these options.

"If a retiree keeps their funds with a plan sponsor after retirement, the fiduciary liability of the plan sponsor changes with the kind of guidance that is to be given," says Ryan Cicchelli, founder of Generations Insurance & Financial Services in Cadillac, Michigan. "Sponsors need to be aware that the strategies they recommend for people at age 40 should be vastly different from the strategies they recommend for someone entering the preservation phase of life. Again, the only contributor to these accounts going forward is the market. They need to recommend people be more conservative and safer rather than continue to chase market highs while simultaneously risking the devastating lows."

The bottom-line: there's no escaping increased fiduciary liability when the plan retains retiree assets.

"It increases the liability by increasing the number of clients the fiduciary is responsible to," says William A. Stack, Owner of Stack Financial Services LLC in Salem, Missouri. "He or she has a direct responsibility to the plan sponsor for current employees, but an additional direct responsibility to those no longer employed."

It's not unusual, then, to see fiduciary advisers recommend to plan sponsors that they encourage retirees to take their assets out of the plan when they've worked their last day.

"Plan sponsors should focus on the fiduciary liability of giving their employees all options rather than just one company," says Michael Foguth, founder of Foguth Financial Group in Brighton, Michigan. "They also should not worry about retaining the assets if or when an employee leaves and or retires. It's not always in their best interest to stay with the same funds that they had years ago during the accumulation phase."

And plan sponsors shouldn't feel too bad about expecting retirees to rollover their retirement assets. The financial world outside the plan has much more ways to customize a tailor-made solution for the retiree. And that really is in their best interests.

"Once the employee separates service, they have additional options relative to where to park their retirement funds," says Ben Soccodato from The SKG Team at Barnum Financial Group in New Rochelle, New York. "To what extent will that employee get advice as to where they're taking distributions from? To what extent is that going to be the most cost-efficient option for the participant? These are different considerations than in the accumulation phase where the employer match and ease of contribution are the key reasons to utilize the plan. Lack of distribution options, lack of investment flexibility, and advice are all reasons to not retain assets, and for many HR professionals, they would prefer to have the assets removed from the plan."

It's hard enough to shepherd employees along the way to retirement. Why should plan sponsors take on the added fiduciary liability to guide former employees through retirement?