A Retirement Plan Sponsor's Guide for Choosing a Financial Advisor

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A financial advisor is one of the most important cogs in a machine known as a retirement plan. While plan sponsors may think that all financial advisors do is just choose investment options for trustee or participant direction, they serve an important function in managing the fiduciary process of a retirement plan. A good financial advisor will help a plan sponsor manage the fiduciary process and minimize the risk of fiduciary liability, while a bad financial advisor will increase that risk. Consider this article as a guide if you are in the market for a new retirement plan financial advisor or to gauge the competency of your current one.

1. Avoid the advisor who custodies his own assets.

This is a simple mistake to avoid, but then ask why the victims of Bernie Madoff got duped. A plan sponsor should never have plan assets in the custody of the very same advisor who is the financial advisor for the plan, this is why Bernie Madoff was allowed to carry on his ponzi scheme because his firm custodied those invisible assets. Plan sponsors should have their assets custodied at reputable plan custodians such as Schwab, Fidelity, Matrix, TD Ameritrade, Hancock, Nationwide, ING, Principal, or any other such custodian because if any plan assets disappear, these custodians have the financial assets to back up any problems.

2. A retirement plan advisor is not the time for nepotism.

All in The Family was one of the greatest shows in television history, but the management of the fiduciary process should not be all in the family. Don't hire a financial advisor because he or she is somebody's relative. Plan sponsors need to develop a process on how they hire their retirement plan providers and any process is suspect if someone's relative gets the job as a financial advisor. Speaking from experience, families going into business with each other often end up badly and certainly won't look appropriate in the eyes of aggrieved participants and the courts in any case involving breach of fiduciary duty.

3. Just because they are your bank, doesn't mean they should be your advisor.

I hear it all the time; a financial advisor loses out to another financial advisor who happens to be affiliated with the bank that the plan sponsor uses. If a plan sponsor has a process to select an advisor and thinks the advisor affiliated with their bank is the best fit, so be it. However, if the advisor was only selected because the plan sponsor believes that it will strengthen the relationship with the bank or increase their line of credit, then they should be aware that such a maneuver may be considered a prohibited transaction which could be subject to Internal Revenue Service and Department of Labor penalty because the plan sponsor is using plan assets (by hiring the bank related advisor) for their benefit (an extended credit line). While such a determination may be remote, plan sponsors should be advised of the risk and ensure that the selection of a financial advisor is through a fair process.

4. Know Their Role.

When it comes to hiring a financial advisor, it's important to know what their role is and that role is as a fiduciary. A financial advisor could serve as a co-fiduciary, an ERISA §3(21) fiduciary, or an ERISA §3(38) fiduciary. In addition at the time this article was written, financial advisors that are stock brokers are not currently defined under ERISA as a fiduciary. Why is the fiduciary role of a financial advisor so important? It's about mitigating liability because a financial advisor that takes on a fiduciary role does limit a plan fiduciary's liability in the sense that the financial advisor would share some of the fiduciary liability in any action for breach of fiduciary duty.

5. Pick an "experienced" financial advisor.

Plan sponsors should pick an "experienced" financial advisor, not an experienced financial advisor. What's with the quotes? Well, an experienced advisor can have so many definitions, so I will just have one definition for "experienced" financial advisor. An "experienced" financial advisor is an advisor who has the experience working as a retirement advisor for retirement plans. It does not mean years in the business, number of retire-

ment plans on their book, or assets under management. "Experienced" means that they have the background and understanding to manage a retirement plan of your size and shape (i.e. 401(k), defined benefit, money purchase, etc.). If you have a $10 million participant directed 401(k) plan for a private company, it may not be a good fit for the advisor of a $50 million multi-employer (union) defined benefit plan. A plan sponsor should hire a financial advisor who can effectively handle a plan that is similar to what they have.

6. Be more interested in substance than style.

There are some financial advisors that are more like performers than they are as actual advisors. When it comes to their materials and presentation to plan sponsors, these advisors are like any good Las Vegas performer. While everyone loves a good show, plan sponsors need financial advisors that have the background to handle the fiduciary process such as developing an investment policy statement (IPS), selecting and reviewing funds based on the IPS, and offering education to plan participants if the plan is participant directed. Plan sponsors should concentrate less on selecting a showman and concentrate more on selecting an advisor who can help with the fiduciary process.

7. What type of investment education does the advisor provide?

If a plan is a participant directed plan, where participants chose their own investments, the most neglected part of running the plan is offering education to them. In order to properly limit a plan sponsor's liability for a participant directed plan under ERISA §404(c) is investment education, so that participants can have enough information on how to direct their own investments. Participant education is one of the most neglected areas of participant directed 401(k) plan, but yet is the most important. Investment education limits a plan sponsor's liability and improves the retirement savings of participants. So a plan sponsor should ask a potential advisor on how they conduct investment education/enrollment meetings and if not, whether they use a service like Smart 401(k) or RJ20 to handle it. Whether the advisor does it or farms it out to someone else, investment education to plan participants is a necessity for participant directed plans.

8. Be wary of the advisor who wants to change the world for your plan.

There are some financial advisors who are willing to work with the plan sponsor's current framework of other plan providers and then there are those advisors who want the plan sponsor to change the third party administrator (TPA) and/or plan custodian. A plan provider change should only be made if it benefits the plan sponsor such as to replace an incompetent provider or to cut unreasonable plan costs. A plan provider change should never be made just because it would make it easier for the financial advisor to be paid. If a financial advisor wants the plan sponsor to make a provider change, they should articulate a reason why such a change would benefit the plan sponsor.

9. Pick an Advisor Who Charges Reasonable Fees, not just the Lowest Fees.

When it comes to plan expenses, plan sponsors must only pay reasonable expenses in the exercise of their fiduciary duty. When hiring a financial advisor, a plan sponsor should only hire one who charges a reasonable management fee which is typically between 20 and 75 basis points, which typically slides down as assets in the plan increase. So while plan sponsors need to pay reasonable plan expenses, they don't need to pay the lowest plan expenses. Sometimes the advisors who charge the lowest fees follow up with the lowest level of service. Plan sponsors should focus less on finding the advisor with the lowest fees and more on the advisor who charges reasonable fees while offering a high level of service.

10. Selecting a financial advisor is a process, document everything.

When it comes to their role as a plan fiduciary, a plan sponsor should always document the decisions they made and why they made it. Therefore in selecting a financial advisor, a plan sponsor should instate a process of selecting an advisor. The process involves speaking to a few different advisors (referrals from other plan sponsors are always great), collecting their informational materials, and the documentation of a meeting in which it was determined how and why the winning financial advisor was selected. Simply interviewing one financial advisor because he's someone's cousin; or affiliated with the bank; or because she has great advertisements in a magazine ad isn't going to suffice. Plan sponsors need the documentation of the process in order to defend their decision, if they ever have to.

Selecting a financial advisor is not an easy process, but hopefully this guide will help the plan sponsor in determining what criteria to use in selecting one.

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