

# Why 401(k) Plan Sponsors Should Make Sure Education and Advice is Offered To Their Participants

By Ary Rosenbaum, Esq.

They often say that the road to hell is paved with good intentions. The meaning of the proverb is rather simple, that individuals may do bad things even though they intend the results to be good, or, that good intentions may not result in a good outcome because of inaction due to procrastination. While employers sponsor participant directed 401(k) plans to benefit their employees, sometimes their good intentions lead to a harmful result of financial liability because of their inaction or incompetence. However, the Department of Labor (DOL) has made a new exemption to allow for financial advice to be provided by plan providers to participants. In order to avoid the road to hell, plan sponsors should make sure that their 401(k) plans allow for both financial education and advice to plan participants.

When participant directed, daily valued 401(k) plans were pushed in the marketplace, it was with the claim that participant direction would absolve the plan sponsors of liability for any losses made by participants in the investments they directed. The problem is that protection under ERISA §404(c) is predicated on the plan sponsor and trustees in fulfilling a fiduciary process.

The plan sponsor must work with their financial advisor in developing an investment policy statement as the basis for selecting investment options that participants could select for their account. In addition under DOL regulations issued under ERISA §404(c), in order for plan participants to exercise control for purposes of making it a participant directed plan, the fiduciaries must provide sufficient information to participants so that they can make informed decisions.

The sufficient information is information such as a description of the investment alternatives available under the plan, including a general description of the investment objectives and risk and return characteristics of each alternative (including type and diversification of assets in the portfolio of the alternative); identification of any designated investment managers; an explanation of how to give investment instructions, and a description of any transaction fees or expenses



charged to the participant's account (e.g., commissions, sales load, deferred sales charges, and redemption or exchange fees). While not legally required, plan sponsor should at the very least, make sure that plan participants get the education to make better educated investment decisions.

Until now, plan participants could only receive investment educations from plan providers and not individual

advice. The reason was that providing advice was considered a prohibited transaction as it appeared to be a conflict of interest for financial advisors and plan providers like mutual fund companies to provide advice on financial products that they were receiving a fee on. Advice needs to be impartial, so the DOL felt that any provider that was going to make extra money based on the advice provided was not going to be impartial. So advice was considered a

prohibited transaction, investment education was not. What's the difference between education and advice? It was more than just words. Investment education is generalized; advice is tailored to the specific financial needs of plan participants. Investment education can be broken down into 4 categories: plan information such as information about plan participation and the investments offered under the plan; general financial and investment concepts such as risk, diversification, and asset classes; asset allocation; and interactive investment materials such as estimating future retirement income needs.

Thanks to a lost decade of investing and the sense that too many American workers don't have sufficient retirement savings, the DOL has tried to implement much needed change to the way 401(k) plans operate. The DOL realized that with the proliferation of participant directed 401(k) plans, the assets were now directed by the people that were the least prepared to make those decisions, plan participants. That is why the DOL has finally implemented regulations that will allow plan providers to provide advice to participants.

Until the DOL issued these new regulations (which will be effective on December 27, 2011) only the largest retirement plans could have afforded to hire independent third party providers to give individual investment advice to participants. So participants of smaller to medium sized plans didn't get advice which is a problem since they were the most likely ones making the investment choices in their 401(k) plan. The DOL claimed that there was evidence that many participants in these retirement accounts make costly investment errors because of flawed information or reasoning. They often don't optimize their investment mix in accordance with generally accepted financial theories. I'll never forget the one former co-worker who put all his money in the mid-cap fund our 401(k) plan has because it was the middle of the market. This is a reason why the DOL felt it had to do what it had to do.

In order to provide advice, financial advisors and plan providers will have to meet the requirements set forth by the regulations and have their attempt at fulfilling the criteria set forth by the exemption to be audited by an independent firm. Of course that means many financial advisors and plan providers will not be able to offer financial advice to plan participants because it's cost prohibitive. Even if a plan sponsor has a financial advisor that can't afford to provide advice, they should engage the services of a third party that will.

Regardless of whether the financial advisor, plan provider, or a third party like [rj20.com](http://rj20.com) provides advice, it is imperative that a plan sponsor makes sure that plan participants get the necessary education and advice. Plan sponsors should take advantage of this new exemption because it will serve the better interests of the retirement plan if they offer education and advice to their plan participants. While many retirement plan experts will note that even when offered education and advice, many plan participants don't use it.

However, not offering it is no excuse.

Too often, plan sponsors forget that one of the major points in setting up a retirement plan is that it is an employee benefit. Studies have shown that the use of investment education and advice has increased the rate of return for participants. So plan sponsors who want to boost employee morale, one way is to help increase the retirement savings of their employees because better informed participants will make better investment decisions and net better returns. An



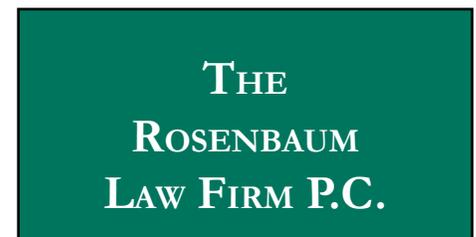
employee benefit is only appreciated if it's a quality benefit and allowing participants the opportunity to get education and advice will certainly add luster to the plan sponsor's 401(k) plan.

People who criticize 401(k) plans or criticize the new advice regulations will claim that participants won't use the advice even if it's offered. They will also say that no matter how good the education and advice is, plan participants won't become investment experts. That may be true, but they are missing one of the major points on why a plan sponsor should offer education and advice. Offering education and advice is one large step a plan sponsor can make is limiting the liability in offering a participant directed 401(k) plan. Offering education and advice goes a long way in satisfying the fiduciary process under ERISA §404(c) to limit a plan sponsor's liability. Poor stock market returns over the last decade has increased the amount of lawsuits that aggrieved plan participants have made

against plan sponsors. The best defense that a plan sponsor can make against such aggrieved participants is to show the courts that they have fulfilled the fiduciary process by implementing an investment policy statement, by reviewing investment options on a timely basis, and by offering education and advice to plan participants. So rather than just claiming that education and advice will help participants save more for retirement, plan sponsors should see it as liability protection. If plan participants don't want investment education and advice, it's their loss and the plan sponsor's gain (in limiting potential liability).

Even though it's not legally required, the offering of investment advice should be something that all plan sponsors should offer. Like a golf club, advice is a tool and it depends on you use it. It can be used to help the investment experience of plan participants and it can certainly be used to help the plan sponsor in meeting their obligation to receive liability protection under ERISA §404(c). Whether it's their

investment advisor or their plan provider or the use of a third party, a plan sponsor should make sure that investment advice is an integral part in offering a participant directed 401(k) plan.



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