How To Reduce Your Practice Retirement Plan Cost

[Editor’s Note: This is a guest post from Konstantin Litovsky, a long-term advertiser here at WCI and an expert in designing low-cost small practice retirement plans. Long-time readers will remember this subject being discussed in the past. If you are an employee, you are basically stuck with the retirement plans offered by your employer, although you can lobby for change. If you are self-employed without employees, an individual 401(k) is a straightforward do-it-yourself retirement plan. However, once you have employees things get a little bit more complicated and it is time to seek professional help. In this post Mr. Litovsky describes what you should be looking for with that help. While the described best solution/advisor obviously has a very close resemblance to himself and his firm, I agree with him that getting a low-cost plan filled with low-cost investments and the best available features is critical as is meeting your fiduciary responsibility to the plan participants. Enjoy the post.]

It is well-known that the majority of retirement plan providers that serve the small and mid-sized retirement plans are bundled platforms that make most of their money via asset-based fees. Many plan providers do not offer the best
available solutions to small solo and group practice plans, and this often means subpar plan design and lack of any fiduciary or compliance services, which leads to higher plan cost and can potentially result in unnecessary expenses [such as litigation-ed] later on. Even those providers who are open-architecture tend to charge significantly higher fees for small solo and group practice plans relative to what the larger plans pay for the same services. However, it is definitely possible to get the best available plan services at a lower cost. The problem is that the information on how to lower your plan cost and improve the service quality can be hard to come by because plan providers are not fiduciaries, and they are not working in your best interest, so they don’t have to get you the best plan money can buy. Below are five ways to significantly reduce your plan cost, especially if your practice has an older plan with significant assets.

# 1 Eliminate All Asset-Based Fees

It is really unfortunate that asset-based fees dominate the retirement plan industry, and you pay a higher fee just because your assets grow, not because you are getting any extra services in return for the higher fee. For example, Group Cash Balance plans are often charged a 1% fee by investment advisers even though the plan portfolio is managed
so conservatively that the asset-based fees will significantly diminish the investment returns over time. Not only are asset-based fees unfair, but they might be costing you hundreds of thousands of dollars in extra fees without much to show for it. There is no reason to pay any asset-based fees for your plan services (aside from the expense ratios of your investments), so always choose plan providers who only charge a fixed/flat fee. [Or at a minimum compare the total AUM fee you are paying and compare it to available flat-fee based providers.-ed]

While some record-keepers and Third Party Administrators (TPAs) do charge asset-based fees for their services, you can always find a provider who charges exclusively a fixed/flat fee. With investment advisers the asset-based fee is much more widespread, but you should still be able to find an adviser (in a fiduciary capacity) who would be willing to work for a fixed/flat fee. Use this calculator to estimate the fees you are paying, and compare with the fees that fixed/flat fee providers charge to see the difference over time. Many record-keepers charge a relatively small asset-based fee (which can be around 0.05% or so), but you can often elect to pay this fee from of your practice cash flow, not from your plan assets. Paying plan fees from the practice cash flow is always better because this is a tax-deductible business expense.

[Editor’s Note: It seems appropriate to take a moment to make a brief editorial note here about the various players involved in a retirement plan:

- **Plan Administrator/Plan Sponsor** – This is the owner of the practice, i.e. you. Fiduciary duty unless delegated to a 3(38) fiduciary.
- **Plan Participant** – This includes your employees and also yourself. This is who the fiduciary duty is owed to.
- **Recordkeeper** – Processes transaction requests, submits trades to custodian, updates participant accounts, and provides information to plan and participants. No
• **Third Party Administrator** – Ensures compliance with tax laws and plan documents. No fiduciary duty. Can be (and often is) the same firm as the recordkeeper.

• **Custodian** – Actually holds the assets that are owned by the plan, like a bank. Think of a firm like Charles Schwab or Vanguard. No fiduciary duty. Often the same firm as the recordkeeper and TPA.

• **3 (21) Fiduciary/Plan Advisor** – Named after a section of code, in this set-up the plan advisor is a partner with the plan sponsor where they are both have a fiduciary responsibility to the participants. Shared fiduciary duty. i.e. The advisor selects a list of five large cap funds and the plan sponsor picks which one goes in the plan.

• **3 (38) Fiduciary/Plan Advisor/Investment Manager** – In this set-up, the plan sponsor has delegated the fiduciary responsibility to the advisor. Thus, while the plan sponsor still has a duty to select and monitor the advisor, he has passed the fiduciary duty to the advisor. Fiduciary duty. i.e. The advisor chooses the actual investments in the plan.

• **Financial Advisor** – Some plans also have someone who gives participants investment advice. Often a broker without fiduciary duty.]
# 2 Lower The Cost of Your Investment Options

It is always a good idea to hire an independent ERISA 3(38) fiduciary adviser for your plan, and this will ensure that you will have someone working in your best interest who will take full responsibility for selecting investment options and building model portfolios for your plan (and who will take on a discretionary fiduciary role when managing investments in a pooled 401k or a Cash Balance plan). An ERISA 3(38) fiduciary should be able to select low-cost index funds and build model portfolios for your plan with an average expense ratio of around 0.15% vs. an average expense ratio of anywhere between 1% and 2% for a typical small practice plan. Not all ERISA 3(38) fiduciaries are created equal though, so you need to make sure that your adviser believes in using low-cost index funds and that they are compensated exclusively via a fixed/flat fee.

# 3 Improve Plan Design

Is your TPA using the best possible design for your plan? To allow maximum available contribution to owners/partners, does your plan use a cross-tested or a pro-rata contribution allocation formula (a pro-rata formula would result in a significantly higher employer contribution to non-owner employees)? Does your TPA review your plan design periodically to make sure that your employer contribution is minimized? Is your salary set correctly to minimize your employer contribution while maximizing your own? The cost of extra employer contribution from a suboptimal design can be significant, especially for a small practice plan.

For a group practice 401k plan, can every partner select their desired level of profit sharing contribution, or is it ‘all or nothing’? Is your group practice plan a profit sharing only plan? It is always better to convert this type of plan to a 401k plan because you can maximize your plan contribution with
a lower salary and also have the ability to do Roth salary deferrals and catch-up contributions for those over 50. Making sure that your plan design is optimal for your practice can allow you to make higher contributions at a lower cost, and including the best available features (such as Roth 401(k) contributions and in-plan Roth conversions) will allow you to use the plan as a perfect tool for long term retirement and tax planning.

**# 4 Use Open-architecture Platform Versus A Bundled Platform**

In a bundled platform it is impossible to replace/remove providers who either don’t perform or are too expensive because everything is integrated into a single platform. Open architecture platform on the other hand allows you to select the best providers (including ERISA 3(38) fiduciary, TPA and record-keeper) and providers can be removed and replaced when they are not doing their job. Also, a bundled platform does not have adequate checks and balances as all of the parts are working for the company that hired them, not for you. It is very important to select independent providers, especially the TPA and ERISA 3(38) fiduciary who will be looking out for your best interest and who are not compensated by third parties. In most cases you can get better pricing (and better services) by selecting each provider separately rather than going with a bundled provider, and using open-architecture providers will also let you significantly reduce (and even eliminate) asset-based fees.

**# 5 Correct (and Prevent) Fiduciary and/or Administrative Breaches**

Having your plan audited by the IRS or DOL can potentially lead to costly penalties and fines, and will require you to take corrective action to fix any fiduciary and/or administrative issues, so why not do it proactively at a
fraction of the cost? While much touted excessive fee lawsuits are still rare (though they are on the rise for smaller plans as lawyers are getting the hang of it), there are many other errors – as simple as an incorrectly filled out form 5500 – which can raise red flags for the IRS, and catching plan errors is getting much easier as everything is now computerized and automated. If your plan is flagged for one error, all of the other potentially significant fiduciary and administrative breaches will come to light, often resulting in hefty fines.

Developing and implementing a prudent fiduciary process is a big part of avoiding fiduciary and administrative breaches. Work with your ERISA 3(38) fiduciary and your TPA to create a blueprint for plan governance, and assign roles and responsibilities to all plan providers and plan trustees. Errors often happen because of lack of communication between plan providers and the plan sponsor, so always make sure that plan providers are on the same page and are talking to each other and to the plan trustees about any potential issues. Your ERISA 3(38) fiduciary should create and implement an Investment Policy Statement for your plan, and your TPA should review all parts of the plan periodically (including your plan’s brokerage windows, especially if your plan allows multiple providers) for fiduciary and administrative breaches, and provide ongoing monitoring to ensure that the plan sponsor is abiding by the terms of the plan document and that the plan is operating in compliance with all applicable laws and regulations. Having proper fiduciary and compliance oversight will eliminate any potential issues with the IRS going forward, and will significantly reduce the risk that your plan will be audited and fined.

What do you think? Have you implemented a retirement plan for your practice? What pitfalls did you encounter? Did you follow Litovsky’s recommendations? Why or why not? Comment below!