Revamping My Small Business Retirement Plan

[Editor's Note: This is a guest post I asked a regular poster on the Bogleheads board to submit to the blog. He is an attorney who wishes to remain anonymous who was responding to a question from another poster about revamping his own retirement plan. It's a great addition (with some counterpoints) to the post from Konstantin Litovsky last week on small business retirement plans. We have no financial relationship.]

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I'm an interested employee doing research on options for improving the 401k plan for the company I work for. My primary goals are to reduce cost and improve fund selection (including the introduction of index funds, preferably without any additional asset-based fee imposed on top of the expense ratio).

One thing that's come up in my research is the possibility of paying somebody to advise us on our plan on an hourly or flat-fee basis instead of based on assets under management (as our current advisor is). How (and how much) does your 401K plan pay your advisor? What responsibilities does the advisor have? Are they a 3(21) or 3(38) fiduciary? Does anybody have any suggestions about how to go about finding an advisor who would work this way? Most references I've come across so far seem to expect a fee based on AUM.

I recommended a provider for, and selected the funds for, the 401K plan that my employer now has with [Employee Fiduciary](https://www.employeefiduciary.com) (EF). At a prior employer, I researched the issue and proposed moving our plan from a high-fee insurance company provider to EF, but the management refused to switch. When one group of employees left to form a new venture, two bonuses of the move occurred to me: (1) I could roll my 401K account balance into a low-fee IRA, and (2) I would make my feelings about the 401K plan at the new firm known before any provider had been selected.

You Might Not Need An Advisor

I searched for an advisor willing to take on an advisory role on an hourly basis, and couldn't find one. As I recall, I contacted a nearby advisor listed with the Garrett Network. I believe that he offered hourly fees in general, but needed to research the issue of whether he could do so for an entire plan. In the end, we never heard back from him, and proceeded to adopt the plan without using an advisor at all. I have to assume that the fear of liability may drive many advisors away, and that the returns of providing a few hours of service a year to a small firm aren't worth the risk of legal exposure. It's also possible that hourly advice to an entire plan is not a task for which insurers have a ready-made coverage package for.

Minimizing Liability

I convinced our management to proceed without an advisor. The firm undertook various steps to minimize the likelihood of financial misadventure. First, the fund handling was set up so that funds were deposited by default into a low-risk money market fund. Thereafter, the funds are only moved into index funds, or target date funds (the only kinds of funds we have) if the employee himself/herself moves the funds there. To further reduce any potential liability claims, we selected a fund mix that mirrored the Federal Thrift Savings Plan (TSP) fund mix, using all Vanguard funds. As I recall, the single most volatile fund in our offering is the Vanguard S&P 500 index fund (VFINX). I believe that an employee at EF first relayed the logic of this approach to me. In brief, the reasoning is that since the plan parallels the TSP, it could only be considered a violation of fiduciary obligation, if it also found the defined contribution plan available to all federal employees (the TSP) in violation. Since this prospect seemed highly unlikely, it appeared safe to proceed in this manner.

For an employee to sue, he would have to tell the judge/jury that: (1) he or she moved funds from a safe money market fund to the stock index fund on his own; (2) the entire U.S. stock market declined; and (3) the employer should be held responsible for the stock marked declining. The ridiculousness of this claim, coupled with the inability of any of us to find a single case (we're lawyers) where anyone had sued, successfully or not, over this type of issue convinced the management to proceed without an advisor.

Fiduciary Liability May Be A Scare Tactic

I mention the liability issue because addressing it is paramount in avoiding the advisory fees. The large insurance firms offer warranties of coverage against any liability arising from an employee lawsuit (however unlikely). They tend to trumpet this risk as the reason to pay the fees required for the insurance company plans. The sound of this tends to scare most employers into falling in line with the large insurance company plans and their 2% annual AUM fees. The irony is that all the lawsuits I could find when searching on the Internet concerned grievances about high fees, not the performance of the underlying investments. *[Such as this one mentioned by Litovsky last week-ed]* The insurance companies also divide and conquer by imposing their high fees mostly on the plan participants while offering the plan decision makers (law firm partners, or managers in a corporation) far superior arrangements with higher contribution limits and limiting the fees paid directly by the employer.

In my experience, fear of lawsuits was the crux of the matter.

It was comparatively easy to convince people of the benefit of passive investing with low fees over active management with high fees. However, convincing owners of small firms to ignore the disingenuous warnings about liability from high-fee providers proved to be much more difficult. One advisor specifically warned our management that they were proceeding dangerously. Luckily, in our case, we overcame his fear mongering. The advisor now hates my guts of course. But, I'm ok with that. I regard the hatred of a financial advisor as a surefire indication that we did the right thing.

What do you think? Would you implement a retirement plan without an adviser? What have you done to keep costs down in your practice retirement plan? Comment below!