The Mitchell Report

Perspective from Leading Advisors

Overcoming Qualified Plan Obstacles

Introduction

One of the most demanding challenges facing advisors today is helping executives resolve the myriad issues associated with qualified benefit plans.

Most advisors choose to avoid tangling with the systemic, technical and regulatory considerations that complicate the advisory process. Also, the professional accreditation required for an advisor to offer qualified plan consulting services is lengthy and demanding.

So when I decided to write an article on qualified plans, it took some detective work to find an advisor with the empiric knowledge to make me look like I knew what I was talking about. I finally stumbled upon a fellow in Philadelphia who came to my rescue.

Steve Leshner, president of Commonwealth Investment Management Group, LLC, is a member of LPL Financial's Retirement Plan Consulting Program, an elite cadre comprising less than 1% of LPL's 12,000+ advisors nationally. Members are subjected to rigorous training and certification procedures permitting advisors to act in a limited fiduciary capacity to retirement plans for investment option selection and monitoring.

I managed to get an hour alone with Leshner as he was preparing to leave his office on a Friday afternoon and fly to Miami to compete in a weekend marathon race. Obviously, this was not a chap who does things halfway.

The Interview

Mitchell: Why are so few advisors qualified to consult on qualified plans?

Leshner: For starters, the accreditation requirements put off a lot of advisors. LPL Financial required I first complete and pass a specialized training program at Fi360 in Pittsburgh to qualify me as an Accredited Investment Fiduciary (AIF).
A requirement of that designation is signing a code of ethics agreement and completing 10 hours of continuing education annually. Following that, I had to successfully complete an extensive questionnaire and submit a process proposal before I could actually undertake a qualified plan (QP) analysis under LPL Financial's Registered Investment Advisor. I subsequently designed a platform for employers to compare vendors, evaluate mutual fund platforms[i] and perform other activities related to maximizing plan efficiency and participation.

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Mitchell: I didn't realize there was such a time and training investment for advisors. I imagine creating an evaluation platform involved some serious research.

Leshner: It did, but having a reliable system, a process that's consistent for each client is critical. It supports transparency, disclosure and information access, not just from a vendor perspective but also compensation, how to put funds on the watch list, and the criteria necessary for employers. Larger plans nowadays typically contain an investment policy statement that is negotiated between plan trustees, custodians, advisors and anyone else involved in the plan. It's sort of a primer on how things should be done and it's really vital that employers understand the ins and outs.

Mitchell: Are qualified plan issues a front-burner concern for employers?

Leshner: Frequently they are not, but the continuing economic malaise should raise grave QP concerns for employers and employees alike: Participants because portfolio values have been eviscerated and they need to replenish their 401k; sponsors because of heightened fiduciary responsibilities as to whether they are asking the right questions and meeting all their obligations.

Mitchell: What are some of the specific concerns plan sponsors should be addressing?

Leshner: The first consideration for most employers is cost, including the administrative, participant and funding costs. While some costs are borne by the employer, in large plans, the participants may absorb most of the delivery costs. Whether the employer makes matching or topheavy contributions is a function of individual plan design and demographics.

Regardless of the plan, there are core costs involved in providing benefits so the first consideration for sponsors is whether they are aware of their plan's actual cost structure and how its derived.

The next issue is whether sponsors have the statistical basis to periodically review the past performance of their plans funds, which funds are on their platform and why.

Other considerations for sponsors are regular reviews of the fund's past performance with the plan's vendor and periodically evaluating alternative vendors to determine if there are opportunities to lower costs.

Aside from the potential savings for participants, sponsors might discover funds offering better performance from other managers, although past performance is no guarantee of future results.

There is also the issue of whether participants have ready access to information. Technical advances not only permit online access but participants with self-directed plans can also make changes with just a few mouse clicks.

Finally, there are regulatory changes to consider. Has the employer amended the plan to comply with the new laws? It's surprising how often sponsors overlook this requirement. For example, summary plan descriptions

must be updated to reflect any new regulations and distributed to employees. There are a host of administrative issues that must be complied with and most can be done electronically.

Mitchell: What investment options must be available on QP platforms?

Leshner: The “Pension Protection Technical Corrections Act of 2007” mandates, among other things, that qualified plans have sufficient diversification of investment choices, including a money market fund, fixed income fund, large, mid and small cap funds[ii], an international equity fund[iii] and a balanced fund. At the time, target date maturity plans (TDMP)[iv] emerged as a trendy offering, asset allocation plans that adjust themselves to assume a more moderate position as a person ages. A properly diversified QP should also include TDMPs, asset allocation plans, index funds, specialty funds and similar alternatives.

Opportunities must exist for both active and passive investors, or “passengers and drivers” as I like to call them. Passengers typically choose a TDMP or other asset allocation fund and allow it to be professionally managed by a platform. Drivers usually prefer self-directed plans where they can make their own investment decisions. A QP today must offer options for both types of investors.

Mitchell: What factors are most important in evaluating a retirement plan advisor?

Leshner: According to the Center for Due Diligence, “Few plan sponsors are fully cognizant of their retirement plan duties under ERISA. While the duties are rarely prioritized, the law requires fiduciaries to implement a prudent process for evaluating and monitoring advisors. Since its inception over thirty years ago, the courts have interpreted ERISA as the highest fiduciary standards known to law. These standards require plan fiduciaries to seek outside experts when they lack the knowledge to fulfill their duties.”

In my opinion, there are a number of criteria for employers to consider, among them the advisor’s licensing, designations and certifications, professional associations and relationships, relevant retirement plan experience and areas of expertise, methodology, access to attendant resources and fees. Employers should make certain the advisor has errors and omissions insurance, offers references and has an unblemished disciplinary history.

Then too, there are several different engagement possibilities. The plan and the platform should be assessed independently. Some sponsors may prefer an objective evaluation of their plan but not necessarily change their relationship. My affiliation with the LPL Financial’s Retirement Plan Consulting Program allows me to conduct such an impartial plan appraisal.

Mitchell: What if the sponsor decides to explore a different relationship?

Leshner: Once we complete our plan evaluation, if the sponsor decides to shop for a new vendor, we can manage the process, including the negotiations. For example, we recently reviewed a plan with approximately $1.5 million in assets and discovered the vendor performance had fallen and was no longer competitive. We brought in three new vendors to make presentations, including discussion of the platform’s qualitative aspects, website efficacy and other germane issues.

That type of competitive interaction gives the sponsor a better handle on what is available, how vendors differ in their platforms, methodology and services, and what selection criteria will best meet the sponsor's specific needs. We act as an independent resource in helping the sponsor make a choice based on knowledge and comparison versus a gut feeling. We're really very good at it.

Mitchell: When you refer to a sponsor's specific needs, what do you mean?

Leshner: Qualified plans can have different objectives. One plan may be designed to provide the most money available for the owners of a closely held organization or small business. Another plan may be crafted to more directly provide incentives and benefits for the employees supporting the business. In the latter case, a 401k plan typically fulfills the purpose. A core issue for either type of qualified plan is to have periodic reviews of performance as well as both employer and employee costs.

Mitchell: Do you also consult on 403b plans for nonprofits?

Leshner. We do and there are some big legislative changes taking place in 2010 for 403b plan sponsors. They must ensure there is consistency in their plan provisions, a written document with a single platform for all participants as opposed to multivendor platforms sometimes utilized by schools, hospitals and other nonprofit organizations. In any case, nonprofit sponsors should have an objective review of their plans.

Mitchell: Why can't sponsors conduct their own qualified plan performance review and vendor evaluation?

Leshner: It's not that they can't, but rather whether they have the tools to do so. For example, we have access to Morningstar's research and analysis services. We can quickly pull up reports on all the major funds and compare them based on performance, costs and other criteria.

But just as important as access to that information is how you interpret it to determine what's most appropriate for a platform. Let's say a fund has historically performed well but dropped off the past two or three years. How does a sponsor untrained in platform assessment analyze that trend? What is appropriate time measurement: one, three, five or ten years? I typically use three years but some situations call for a different time frame.

How well has the fund done in relation to its peer group benchmarks? Should the sponsor change platforms? Why has performance faded? Did the find manager leave? Did the fund shift style or make a strategic change? What other changes took place that might be relevant?

The Morningstar analysis let's us consider all these factors and their relationship to one another. We also employ sophisticated software available exclusively to the investment community to help us evaluate and draw assumptions. A plan sponsor may not have this access or may lack the financial acumen to accurately interpret the information.

Mitchell: That sounds like an exhaustive process. Does the analysis also compare expenses?

Leshner: Yes, expenses are another important consideration. One fund may charge 80 basis points, another fund 1.25 basis points. Why the difference? Just because a fund or a fund family has lower expenses does not necessarily mean it's a better choice; remember, fund performance is measured *after* expenses. Expenses rather than performance frequently drive fund marketing so it's easy to make misjudgments.

We have the ability to take a quantitative view of the numbers and help sponsors make informed decisions. We also understand that we are dealing not just with numbers, but also with organizations and their people. Workable, satisfying solutions to plan issues are the result of successfully managing working relationships between people, and we believe we excel at that critical aspect of the process. We have a development and training program that delivers a qualified plan to employees wherein all the components are integrated and work seamlessly. The experience and resource relationships we bring to the table make a big difference and that's a big part of our value proposition.

Mitchell: Can you give me an example where your analysis of a plan's cost structure saved an organization hard dollars?

Leshner: I prefer not to talk about specific cases because each situation is unique, but if you insist…we reviewed a plan earlier this yr where the vendor was charging the sponsor $6,500 annually for plan administration. When we dug into the particulars, we found the platform had a poor fund mix. The platform not only had insufficient choices, it had bad choices and the employer was potentially at risk from a fiduciary standpoint.

We found other problems as well. In addition to the employer's $6,500 administrative cost, the employees were paying 1.2% for the funds. The platform simply was not competitive.

We installed a new plan that lowered administrative fees by approximately $2,000 annually while also reducing employee expenses. Even more important, we did some pension consulting and redesigned the plan so it was no longer topheavy and now offers a full array of fund choices. We found many employees didn't understand how to use the platform and weren't participating, so we conducted special sessions for them. As a result, overall enrollment increased, from 40% to 90% in one location. We do the enrollment for every plan we install.

Mitchell: Any final thoughts for plan sponsors?

Leshner: Sponsors are required by law to fund their qualified plans on a timely basis, communicate and provide information access about their plans to employees, and as fiduciaries, exercise due care in the selection and provision of correct choices for employees whose funds are self-directed. That's a big responsibility and sponsors need a process or the ability to make those decisions intelligently. There is no "ignorance" excuse for non-compliance. So it only makes sense to review their plan from time to time.

A periodic plan review by a qualified consultant can provide an objective assessment of the costs within the plan for employer and employees alike. It will also help the sponsor understand how the assets placed in the plan's various funds are performing as evaluated by an independent standard. Finally, the process of periodically reviewing the plan supports the fiduciary responsibility inherent in being plan sponsor.

Mitchell: This has been a really informative session; thanks again for your time and all the helpful information, Steve.

If an employer or plan sponsor has additional questions, how can they reach you?

Leshner: I'm available at 267.794.3001 or they can email me at steven.leshner@lpl.com. Securities offered through LPL Financial, Member FINRA/SIPC.

Michael Mitchell is an independent financial writer based in San Diego.

This information is not intended to be a substitute for specific legal advice. Please discuss your specific issues with your legal counsel.

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[i] Investing in mutual funds involves risk, including possible loss of principal. Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

An investment in the Fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the Fund.

[ii] Small and mid-cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

The prices of small company stocks are generally more volatile than those of large company stocks.

[iii] International and emerging market investing involves special risks, such as currency fluctuation and political instability and may not be suitable for all investors.

[iv] Target date funds typically feature an approximate date when investors plan to start withdrawing their money. The principal value of the fund is not guaranteed at any time, including at the target date.