Breaking Up . . . Is Easy to Do? When to Upgrade Your Financial Advisor

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There are some primary reasons to change your or your client's financial advisor: fees, fiduciary responsibility, investment choice or performance (they are two different reasons), customer support (including with compliance and/or audits), lack of employee education leading to low level of engagement or employee complaints, a user-unfriendly website . . . and more. But a plan sponsor and/or committee then also has to consider whether a potential change is worth the hassle, including but not limited to a blackout period, a new website for employees to learn, reconciliation of records . . . really, is it worth the time and aggravation? The clear answer is that sometimes it is not always whether the time is worth it, but rather whether the Employee Retirement Income Security Act of 1974 (ERISA) leads one down that path, or could the current provider simply not be worth the potential litigation!

There are many reasons for staying in a business relationship that is not working. Personality should be at the bottom of the list to stay, but often financial advisors (FA) work hardest at establishing a relationship with the client (golf, anyone?) to make it much more difficult to change firms. Not all business relationships, however, should survive a personal relationship . . . especially a relationship under ERISA. There can be many reasons to leave an ERISA relationship than to stay, despite golf, a slick website that pleases plan participants, even good investment performance. This article discusses why there are times a plan sponsor *must* change investment advisors, as well as all of the factors that should be considered when weighing the potential to go through a Request for Proposal (RFP) process.

The first step in a determination of whether to proceed through the RFP process is from the FA itself. Specifically, each meeting with the FA is an opportunity to assess some of its critical skills . . . primarily, listening. Even where the client has signed all the necessary agreements to delegate all investment decisions, the client remains responsible under ERISA for monitoring performance; this means more than just returns. If the FA is losing the client's confidence, it is critical to determine why this is occurring beyond sheer numbers. For example, where an FA with a lack of appropriate training was called upon to explain lagging investment returns during the first tech boom, he consistently referred to the fact that the firm was investing in "quality" stocks.

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When pressed for the definition of "quality," the FA was unable to satisfy the investment committee by his stock answer of the tech stocks were not relying upon earnings but rather on potential. This explanation of course was credible, but he failed to explain how a company like Amazon or Facebook could begin to show significant earnings and be a strong investment. The truth was that he was a salesman, and that he had not taken the time to go back to his investment group in order to support the firm's position.

The follow-up problem was that of course these and other tech stocks began to make historical gains while the investment philosophy of the FA was too slow to realize the world was changing. When continually asking why the portfolio did not change its definition of "quality" while the world was changing, the representative continued to talk about a repeat of the bubble as well as how fixed income was a safer investment. The result: the plan lost complete confidence in the firm despite its original intelligent position; when the world changed, the investment strategy did not, and the individual FA lost the confidence of the committee by sticking to an inadequate explanation. Not only the one client, but many clients left the firm appropriately based upon a lack of confidence in both explanation and follow-through.

There are many lessons to be learned from that unfortunate instance. First, an investment committee should feel the freedom to ask to speak to the investment decision-makers to dig deeper when the representative's explanations are not satisfactory. In the event the firm refuses, a committee should consider the inaction a red flag and continue to investigate further. Second, the committee can tell the FA that the particular representative needs to be replaced by another because confidence is being lost in the overall investment (or other area of the firm) strategy. It is clear, based upon years of experience, that clients freeze in their tracks when there have been years of success, or even simply a lack of significant underperformance, due only to habit or laziness. There is no exception under ERISA for failing to meet fiduciary duties for the failure to act due to a long-term relationship. Rather than staying together for the "kids" (participants, committee, the CEO who golfs with the representative of the FA), tough decisions must be made to look elsewhere, even if just for comparing what is available.

To the contrary, a large not-for-profit hired an FA firm primarily for expanding its line-up of mutual fund choices as well as to relieve its volunteer ERISA committee from as much potential liability as possible. A new director of Human Resources was hired, and she was determined to bring in all of the vendors she had previously employed, including a 401(k) specialist. The FA in place had been doing an excellent job, the committee was pleased, the participants liked the website and the returns, and all was right with the plan. The HR director and her new benefits specialist went to great lengths to show the committee why it should change to a large insurance company. More than one of the committee members insisted that there should be no change, but the RFP process commenced with the HR director's very large insurance company vendor brought in as a finalist. Despite repeated warnings from committee members, including but not limited to the annuity feature that would cause significant penalties in the event an employee did not leave his or her fund balances in place for seven years (including past terminating employment), a switch was made. The HR director was eventually fired, but that did not change the fact that the company had left an excellent fit in exchange for buying into penalties and problems from the new vendor. The committee must use independent judgment to ensure the appropriate factors are considered when determining whether to move forward with an RFP, and especially with a change, including whether it is a move for the sake of an ego rather than ERISA. So while breaking up should not be hard to do, a break-up must be done for the appropriate reasons.

While clearly a participant's primary goal is to make as much money as possible, it is up to the FA to provide education that goes beyond just the numbers. While consistently poor investment returns, below benchmarks, cannot be excused by the FA saying, "There's more to investing than return," we know that a "good experience" for participants depends solely on the amount of retirement income amassed. An interesting recent study by the Alliance for Retirement Income surveyed pre-retirees between the ages of 56 and 75 with a minimum of $100k assets about the impact of COVID-19 among other issues.[1] According to the data, a full 70% are more pessimistic about retirement plans than before the novel coronavirus (COVID-19) hit. In addition, 56% are "rethinking" their retirement plans, including how much money they will need or when they plan to retire. The bottom line is that an estimated 3.2 million people have now decided to retire later than originally planned. Because this data reflects only those with retirement plan balances of $100,000 or more, that actual number of those who have decided to retire later logically must be much higher.

Further data supports that position. Only one-third of respondents were "very confident" that they will have the income to cover all of their expenses in retirement. Although most respondents have "some confidence" about their financial preparation for retirement, the pandemic and resulting economic crisis that had yet to manifest at the time the data was gathered has begun to erode the optimistic outlook buoyed by more than a decade of a record bull market.

The result is that these participants are searching for some type of safety, yet a fixed-income investment at this point is a guarantee only of very low returns and the lurking danger of rising interest rates that would negatively impact the current value of the underlying fixed-income vehicle. Accordingly, nearly 25% of respondents say the crisis has prompted them to consider the benefits of an annuity that provides "protected lifetime income," a 37% increase from a similar study released just a quarter before. Furthermore, an overwhelming majority—86% of respondents—said they know annuities provide protected monthly income that can help cover their basic expenses in retirement.

How does this data fit into whether or not to change a plan's FA? First, it reflects that investment returns are not the only issue, as security has raced to the forefront. Second, it shows how thinking can change quickly, and how short-term, significant problems can alter a career-long strategy. Not to say that the issues are not real and evoke appropriate fear, but this is the time when the relationship with an FA should be evaluated to determine if it is up to the task of pulling participants back to see a bigger picture while at the same time working with the plan sponsor to review potential alternatives.

Accordingly, an FA should work closely with the plan sponsor to recognize what the problems are by first keeping informed about trends such as that described above. Then, how these problems might significantly impact the workplace should be researched to forge an attempt to cause seminal events such as COVID-19 to possibly be turned into positives rather than cause thousands of people-hours to be lost to anxiety-filled fixation on retirement planning. If the plan's FA does not fit that bill by offering suggestions such as looking into the cost of annuities as a retirement option, perhaps it is time to look further into other firms that may have a deeper bench with more experienced players.

The committee plays a large role in what is needed from an FA. For example, the data above included statistics that by their nature are anxiety-producing because they are out of the control of employees. This was recognized in 47% of participants believing their retirement was partly based on factors out of their control, and 52% not being "fully confident" they will be able to retire when they want. FAs with significant experience will understand that an employee that has stayed too long on the job in an attempt to accrue further retirement funds is much more likely to not perform at a high level, be less satisfied in the workplace (which, like a cold, can spread quickly), and take space at the higher end of the promotion pyramid resulting in younger employees being less satisfied and more likely to look elsewhere for rewarding employment (regardless of the retirement plan). Thus, when only 33% feel "very confident" about having sufficient income to meet all expenses in retirement, the trend will be that those anxious employees will remain on the job for the wrong reason. In short, while many surveys discount satisfaction with a retirement plan among employees under 45, satisfaction of retirement savings of employees above 45 can upset the balance in the workplace. An FA that looks beyond the numbers and discusses these types of trends, has insight into broader employment issues, understands the plan sponsor's business and where it stands within its industry, and can educate the committee on these issues in the same way it attempts to educate participants about the realities of retirement planning, is in all likelihood going to be a better partner . . . one that is worth keeping or finding as the case may be.

Unfortunately, many employers and committees are not open to changing what occurs inside their walls in order to allow the FA to be better, and to make a stronger and more effective partnership. For example, our firm had the unfortunate experience with a client of not being privy to the 401(k) committee's schedule. As a result, because the business would not follow our recommendation to conduct at least a semi-annual review meeting for a plan its size, we were unable to communicate the recent Setting Every Community Up for Retirement Enhancement (SECURE) Act, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and the impact of COVID-19 on retirement plans; in other words, the issues discussed above. It takes a partnership to have an FA that performs efficiently, and this relationship was not working. It was only when we convinced the committee that we needed the opportunity to act more like a business partner than what a discount brokerage house could offer were we invited in to rekindle what had been the determining factors in the business choosing to hire us in the first place. By allowing the FA to invest its considerable resources in the plan as part of the entire business, and not just as a client to give investment options on a website, we are able to address more than just the primary goal, which is retirement security. In turn, employees were able to express their concerns to us during our one-on-one meetings and we proposed changes to the plan design that, without cost, provided a better partnership for all.

It is worth noting that the FA's principles should align with the plan sponsor. At the Waterford Group, we encourage participants to take advantage of the funds that we have selected based upon our research. We will not, however, branch out and offer participants other services such as life insurance or other investment products. Simply put, we believe that an FA should not be selling other services from inside the plan. When, however, a good relationship is formed with participants due to group education, one-on-one meetings, and satisfactory performance, expectations can change. It is yet another reason to constantly be in touch with the committee so that a separation does not occur for reasons not adequately understood. A dissatisfied participant based upon appropriate boundaries, or unrelated anxiety due to COVID-19, should not run out of control and result in a participant who wants something the FA does not provide due to appropriate boundaries to become a red herring.

According to the Betterment Resource Center, it is incumbent upon plan sponsors to understand the following both by definition and with regard to its plan:

- What are your current investment options?
- What kinds of vehicles are used (mutual funds, exchange traded funds (ETFs))?
- Are funds passively (that is, indexed) or actively managed?
- Are funds reasonably priced?
- Is participant investment education incorporated into the approach? For an additional fee? How personalized is the education?
- What is the default investment (used when participants fail to make an investment election and money is deposited into their account), and how personalized is it to each participant?
- Do participants have investment flexibility?
- *Current Plan Design*: What features (automatic enrollment, safe harbor, and the like) about your current plan do you plan on retaining? Are there features you would like to add/change/remove when you change providers? Now may be a good time to consider these.
- *Current Service*: Although you and other team members may have opinions about the quality and level of service to you as a plan sponsor, be sure you also gather information about the level and quality of service your employees receive from your current provider.
- *Payroll Integration*: Whether or not your current 401(k) provider is integrated with your payroll provider, how smoothly have things been running? Is payroll integration something that is important in a new provider? Be sure you understand the different levels of payroll integration and which responsibilities you may retain.
- *Compliance and Audit Support*: Are you getting the compliance and audit support that you need without any unpleasant surprises? Are documents provided for your review and approval accurate and timely? When you have needed to consult on compliance issues, do you receive clear and helpful answers to your questions? Does the provider deliver a comprehensive audit package to you if you need it and collaborate well with your auditor?
- *Participant Education*: What kinds of educational resources are available to

your employees not only when they first become eligible for the plan, but on an on-going basis as well? Does the platform help employees establish their retirement goal and track their progress toward it?

- *User Interface*: How easy is the user interface and how well does it meet the needs of your employees? Is it easy for them to make changes, find information?

- *Financial Wellness*: Does your provider help employees beyond the 401(k)? Does the platform allow them to sync outside accounts and track other financial goals?

- *Participant Engagement*: Are your participants making good use of the plan, with a healthy majority of employees making contributions at healthy rates? If not, is it because of the plan design or is it more a function of the provider's tools, resources, and approach? For instance, is there enough guidance to help people make decisions or are employees left to their own devices to determine how much to save and which funds to use?

Once the plan sponsor understands all of these issues, its committee can walk through each one with the director of Human Resources or other appropriate person in order to determine satisfaction level and whether prior choices are still appropriate. In addition, the current agreement with the investment provider should be reviewed to determine if the plan sponsor's hands are tied even if dissatisfied . . . and of course to learn that there should always be an "out" clause in the event the plan sponsor is ready to leave. Other factors touched upon above but needing full investigation before deciding whether to go forward with an RFP include:

- *Current fees*: While this seems simple, it requires a deep dive to determine how much the plan sponsor and participant are each paying. The fee disclosure documents may provide all the information needed, but are often too difficult to understand all of the information. Fees may include recordkeeping fees, audit fees, compliance fees, investment management fees and fund fees. Extras may include: legal fees; plan document and amendment costs; loan, qualified domestic relations order (QDRO) or termination fees.

- *Fiduciary responsibilities as evidenced in writing*: Today's committees often understand the importance of being protected, but still may believe fiduciary insurance is adequate. While it in fact usually is sufficient, the issue is not just about potential monetary damages, but also about the level of expertise and burden the committee and/or plan sponsor is willing to take on. Simply put, all ERISA § 3(38) advisors are fiduciaries in selecting investments, and it is worthwhile to hire such protection in nearly all cases. Compare the ERISA § 3(21) advisor that provides only "recommendations," which leaves the ultimate responsibility with the plan sponsor.

- Fiduciary responsibilities with regard to administration is often overlooked. In fact, most plan sponsors are not familiar with the term "ERISA § 3(16) services." Those services with regard to the plan may be designated to a third party or not, and it is critical to understand what are included. Specifically, for 401(k) service providers these duties could includeL

- ○ Determining employee eligibility;
- ○ Providing disclosures to employees and other participants;
- ○ Providing statements to employees and other participants;
- ○ Fixing errors in the plan leading to compliance test, nondiscrimination test, and actual deferral percentage/actual contribution percentage (ADP/ACP) test failure;
- ○ Signing and filing annual 5500 forms (as required); and
- ○ Approving and processing loans and distributions.

This article provides a starting point for both assessing a plan sponsor's current situation and determining whether it is time to reassess its choices. One factor we have not addressed is trust; once the process to understand what is in place is completed, the plan sponsor must return to its current provider(s) to see the level of trust appropriate in the current state. The path forward will make itself clear once the institutional education is complete.

NOTES:

[1] https://www.allianceforlifetimeincome.org/feature/americans-more-pessimistic-about-retirement-plans-due-to-pandemic.