Breakdown of ERISA based plans:

If you have an ERISA (Employee Retirement Income Security Act of 1974), there are certain activities and professionals you need to include in order to meet ERISA guidelines. Some plans are more strict than others. Some plans have more of a framework than others, usually depending on the companies and professionals that are used. Here is a brief overview of most plans:

2 Types of Plans

Defined Contribution- Plans where the participant selects how much they want to put into the plan, allowing the investment returns to dictate their retirement totals. For example, contributing 5% of salary or choosing a dollar amount of $500 per pay period.

Defined Benefit – Plans where contributions are made on behalf of the employee based upon the distribution or lump sum amount desired by the plan. Think pension plan. At time of retirement, you will have $X in a lump sum, or guaranteed $y payments per year through your life. Much more highly regulated with many more moving parts and expenses.

2 Types of Accounts

Participant directed – Most 401(k) plans. Participants get their own accounts and decide their own investments based upon the selection that the trustee and investment advisor create for them. Funds are not comingled, and there is a recordkeeper that has the framework to run these plans such as Vanguard, Fidelity, American Funds and many more. Trustees reduce their exposure through 3(21) or 3(38) fiduciary agreements as well as by having the investment advisor give investment direction through enrollment meetings, annual education and individual investment advice.

Pooled Accounts – Typically better for smaller (1 or 2 person plans). These plans typically allow for the investment advisor to take on more of the investment risk as a discretionary fiduciary. For a smaller plan they can be more cost efficient. Issues with these plans become the costs of TPA recordkeeping and the lack of transparency with account balances for each participant. If the investment advisor takes on too much risk, the trustee is on the hook for choosing that investment advisor and leaves themselves open to litigation. The rule of thumb on these plans is typically to be more conservative since ages and risk tolerances are rarely uniform across the board.

Professionals and Roles

Plan Trustee – The plan trustee is the owner(s) of the business. When you offer a plan for your employees, you act as a trustee, whether you realize it or not. There is no professional that can completely take that responsibility from you. There are arrangements that you can have to reduce your exposure and those are 3(21) or 3(38) fiduciary agreements. When all is said and done, the business owner(s) create the plan and all final decisions flow through them.

Corporate Trustee – This is an external person or trust company that takes on the responsibility of any plan. Typically, these are more for larger Defined Benefits Plans or ESOP's (Employee Stock Ownership Plans) as they are costly, and the cost/benefit needs to make financial sense.

Investment Advisor (IA) – The person or company that advises the trustee as to how the plan should be administered as well as the investment options within the plan. Not all advisors have the fiduciary responsibility that you may think they have. If the plan is fee based, as opposed to commission based, the advisor takes on more responsibility. Also, the IA may be able to take on more responsibility through 3(21) or 3(38) arrangements. They also help to educate the participants in participant directed accounts, and if licensed to do so, may offer advisory services to the participants.

Recordkeeper – This is the company that has the framework for the plan to be designed on and keeps track of the participant balances as well as the technology for participants to log onto their accounts and manage their contributions, distributions and investment selections. If a pooled plan, the TPA charges additional fees to act in that role, as it is a requirement under ERISA to have someone keeping record of the plan amounts/contributions/distributions/loans per participant.

Third Party Administrator (TPA) – The TPA helps the trustee keep to the rules defined in the plan document (the document that was created at the onset of the plan that defines the rules of the road based upon ERISA guidelines). Additionally, the TPA will file the tax form 5500 at the end of every year, as well as do any testing that is required to make sure the plan is in compliance.

Actuary – Only needed with plans that require plan testing. Top Heavy testing for 401(k)'s, Defined Benefit plans, profit sharing, ESOP's, etc. Not required for Safe Harbor 401(k) plans. This company may or may not be the same company as your TPA.

Valuation Expert – In plans where the value of the firm needs to be done on an annual basis, ESOP's, a valuation expert is required.