

Medical Practice Retirement Plans

The Perils of Excessive Choice

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There are several platforms available for qualified retirement plans for medical group practices. Typically the broad headings under which these fall are “defined benefit plans” and “defined contribution plans.” In a defined contribution plan (401(k), profit sharing, etc.), pretax dollars can be contributed by the employer, employee, or both to fund the plan’s investments. In a defined benefit plan (cash balance, flat benefit, unit benefit), the employee is entitled to a predetermined pension benefit at retirement and pretax dollars are contributed by the employer during employment to fund the specified benefit. The investment strategy and choices for plan participants are generally determined by the fiduciaries of the company. Typically in a medical practice, this is the responsibility of the physician-partners.

Partners in a medical group frequently do not share the same ideas about investing. Physicians, in general, value their opportunity to make independent decisions. These tendencies lead many medical groups to default to an investment strategy that allows the most choice available to participants. Self-directed brokerage accounts allow participants the freedom to invest their retirement dollars over the entire spectrum of choice. Some might pick concentrated equity positions while others are able to invest in mutual funds. At first blush this may seem an appealing concept, but there are significant hazards that self-directed brokerage accounts pose to both the physician-owner and all plan participants.

Medical groups offering retirement benefits such as 401(k) or profit sharing plans should comply with section 404(a) and 404(c) of the Employee Retirement Income Security Act (ERISA). A plan sponsor that fully complies with 404(a) and 404(c) has a strong defense against participant claims stemming from poor investment performance. Part of a plan sponsor’s fiduciary duty under 404(a) is to have a prudent process for selecting and monitoring the investment options available to participants. Since most medical groups include the entire group of doctors in the plan sponsor decision-making process, all doctors of the practice would be considered fiduciaries and, therefore all would be responsible for monitoring the participants’ investment decisions.

Fred Reish, a leading qualified plan attorney, points out that if a participant-directed 401(k) plan does not comply with 404(c), the plan fiduciaries are responsible for the prudence of the participant investment decisions (see article at www.reish.com/pa/benefits/jpbjan2003.cfm). If there is no monitoring policy in place to

comply with section 404(c), should one of the plan participants be unhappy with an investment decision he or she made in their qualified plan, the sponsoring medical group could be held liable.

Additionally, recent studies have shown that the investment performance of self-directed (self-directed brokerage) accounts is generally inferior to managed model portfolios¹. According to these studies, “72% of all self-directed brokerage account investment returns lag behind equally weighted managed model portfolios constructed from the core funds in a plan [by an average of 4.7% annually]”.

ERISA requires that plan fiduciaries (ie., the sponsoring medical group) act prudently and for the exclusive purpose of providing benefits for participants. Given the discussion above, it is reasonable to question the prudence of offering self-directed brokerage account options to participants. ERISA has many requirements for plan fiduciaries. Many of those requirements that deal with investments can be met by taking a few simple steps:

- 1) Create an environment in which the investments may be prudently monitored by the fiduciaries on an ongoing basis for the benefit of the participants.
- 2) Have a process in place, by developing an investment policy statement, which contains general criteria of how the fiduciaries select and monitor the investments in the plan.
- 3) Provide ongoing education to plan participants that explains how the plan works, the investment options available (provide prospectuses), and the fact that the plan is intended to be 404(c) compliant.

In the design and selection of qualified retirement plans, medical groups need to exercise caution in defaulting to an option which merely offers participants the widest latitude in investment choice. Federal guidelines place fiduciary liability on the plan sponsors (typically the physician-partners) who may be held responsible for poor investment decisions should the plan not meet a level of due diligence in selection and monitoring of investment choices. Additionally, data shows that when the performance of self-directed brokerage accounts is compared with that of professionally managed portfolios, excessive choice often leads to underperformance.

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