Church Retirement Plans: A Moral Dilemma

January 31, 2011

Without delving too deeply into philosophy, it is probably safe to say that some people are compelled to do the right thing, whatever the situation may be, only because of fear of punishment. As a young child, if the opportunity presented itself to take an extra cookie and not get caught, I may very well have taken full advantage of the situation (forgetting that my parents were pretty good at counting). However, more often than not, I abided by my parents' wishes because of the punishment that was bound to be visited upon me if I were to literally get caught with my hand in the cookie jar. As adults, the ethical and moral situations we face are a little more complex, but often follow the same principles. Laws are in place to define behavior that is acceptable and unacceptable, and punishments are defined to ensure that the laws are followed. For example, there are laws that define the punishment if someone is caught stealing, and for many people, the fear of punishment is all that stands in the way of loading up with free stuff. For others, the fact that there is a law against stealing is largely irrelevant. Stealing is morally wrong and therefore off the table as an option (which maybe still stems from a fear of punishment, but that is a longer-term issue).

Financial laws and regulations are in place to protect investors from financial harm, and to make sure there is consistency in the behavior of companies and individuals who are in a position to affect the financial well-being of others. Again, it is probably safe to say that the only thing standing in the way of some advisors and brokers from cleaning out a client's savings account is the fear of getting caught. The proof of this is the numerous cases of financial professionals who do get caught. The moral opposite of this situation would be an advisor or broker who faithfully carries out their fiduciary duties, ensuring that client interests always come first and that services are performed with a high degree of professionalism and competence. Unfortunately, there is a lot of gray between these two opposites, or at least a lot of opportunity for well-meaning and morally-upstanding professionals to debate. Where is the balance between fair compensation and excessive fees? What does it mean to act professionally or with prudence? How can these standards be applied fairly and consistently to the general public. This is where the Employee Retirement Income Security Act of 1974 (ERISA) comes in for retirement plans.

ERISA Guidelines – It's The Law

ERISA establishes minimum standards for pension plans to help protect the assets of the millions of Americans who need to save for retirement. For example, ERISA specifies when an employee must be allowed to participate in a plan, how long they can be away from their job before it may affect their benefits, and whether their spouse or dependents have a right to their pension in the event of their death. ERISA also establishes accountability for ensuring that the plan benefits the employee as opposed to the employer. The plan fiduciaries are required to act in the best interests of plan participants by ensuring that the plan does not charge excessive fees, that investment options are appropriate, that there are sufficient investment choices, and several other requirements that ensure a minimum standard of care. ERISA also requires plan fiduciaries to act with "prudence", which is commonly viewed to mean acting with a professional-level of competence in a particular area. Protecting an employee's retirement savings is much more complicated than a "don't steal money" law, but it's important to have a set of minimum guidelines in place to ensure employees are treated fairly and consistently. A plan fiduciary may sincerely desire to do a good job and act in a fiduciary capacity, but if he or she has limited competence in the area of retirement plans, an employee's retirement savings can suffer the same result as if someone stole it. Under ERISA, a fiduciary who does not follow acceptable standards of conduct may be required to restore losses to the plan. This is good, because for most people, their retirement savings tends to be a serious subject.

The Special Case Of Churches

One part of the ERISA description I left out is that ERISA applies to private industry companies. Non-profit organizations are exempt from ERISA, but churches and church denominations are a special case. As long as they don't contribute directly to the plan, churches can either elect to implement a non-ERISA retirement plan or make an irrevocable election to be covered by ERISA. Most churches elect not to be covered by ERISA, which eliminates the regulatory hassle and has a number of side benefits:

- No reporting and disclosure requirements
- No financial audits
- No spousal consent requirements

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- No plan document
- No prohibited transaction rules
- No federal fiduciary obligations

For a church, the downside of a non-ERISA retirement plan is the potential for lawsuits related to state law violations. ERISA contains protections against lawsuits for state law violations such as negligence and employment law violations, and it protects plan fiduciaries from punitive damage claims.

The Church as an Employer

Taking a look at the above list of non-ERISA benefits, how does this look from an employee perspective? The plan the church secretary has diligently channeled her retirement savings into…

- has no disclosure requirements
- is not subject to financial audits
- has no plan document
- has no conflict-of-interest safeguards
- does not have a Plan Fiduciary who accepts responsibility for the plan
- has no safeguards against unreasonable fees

The list could go on, but the bottom line is that it is difficult to see how a church employee, who is just as concerned about his or her retirement savings as someone working at Wal-Mart or Joe's House of Plumbing, benefits from the lack of guidelines. The alternative is problematic, and can be seen simply by trying to identify who the Plan Fiduciary would be for an ERISA-compliant church retirement plan. The church pastor is not likely to have the knowledge and skill to carry out financial fiduciary duties "with the care, skill, prudence, and diligence" of a financial professional. The church's executive committee or financial committee might be a better choice, but these committees are constantly changing membership, and who would want to take on the job of committee member if it also means assuming personal financial liability for the retirement plan? A third choice would be to choose a Plan Provider who is willing to assume the role of Plan Fiduciary, but good luck trying to find one when most major providers are bending over backward to ensure that they are not considered to be fiduciaries (although a few exist). The end result is that most churches elect out of ERISA, which makes most of the problem go away. But now we have a moral dilemma. Should there be a lower standard of care for an employee's retirement savings simply because they work for a church?

Tax-Sheltered Annuities and 403(b) Plans

403(b) plans were created in 1958, and originally participants could only invest in annuity products, so the name Tax-Sheltered Annuity (TSA) stuck. TSA plans have been allowed to include mutual funds and retirement income accounts for churches since 1974, but insurance companies were the original providers of TSA plans and continue to be entrenched as plan providers to churches. 403(b) plans are typically serviced by vendor representatives who have a product to sell. According to Dan Otter of 403bwise, "participants have often been sold unsuitable, high-fee products with onerous surrender charges that benefit the representative more than the participant."

In the private sector, all of the attention has been focused on 401(k) plans. ERISA established standards for fiduciary obligations, Plan Providers and Administrators have faced intense competition in terms of fees, expenses, and investment choices, and there continues to be a shift from product-aligned sales representatives to independent, client-aligned advisors. These are all improvements that tend to benefit the plan participant, but many church employees are missing out because their church plan is stuck in a model that was developed 40 years ago or more.

Churches can use 401(k) plans and make a non-ERISA election, which opens up a much larger world of Plan Providers that have been battling it out on service and cost in the private sector. The main difference between a 403(b) plan and a non-ERISA 401(k) plan for a church is the 403(b) Lifetime Catch-up Provision. The Lifetime Catch-up Provision is available to employees with 15 or more years of service with a qualified organization, and allows employees to contribution an additional $3,000 per year, up to a lifetime limit of $15,000. For an employee over age 50, this could raise the allowable annual contribution from $22,000 to $25,000, although as with most things, some restrictions apply.

The Dilemma
ERISA requires retirement Plan Sponsors to name an entity, either a person, group, or position, who will act in a fiduciary capacity and ensure that employees' retirement savings are protected. Among other things, this includes ensuring that costs are not excessive, that investments are appropriate for employees, that employees receive proper education, and that sufficient diversified investment choices are available. These requirements are in ERISA because they are necessary for the safekeeping of retirement investments, and without the law and its associated punishments, some employers would take advantage of employees, either intentionally or simply through neglect. However, similar to the example of stealing cookies, other employers do not need a law to know that treating their employees' retirement savings with care and professionalism, and acting in the employees' best interests, is simply the right thing to do. There is a moral obligation as well as a legal obligation. The fact that a church is not subject to ERISA guidelines does not free them from the moral obligation that ERISA attempts to enforce by legal means.

What A Church Can Do
Most churches do not have an investment professional on staff who can operate as a plan fiduciary, and most committee and Board positions are temporary. Because of this, churches tend to stick with the plan that was sold to them sometime in the distant past, by a company that has a very nice salesperson who delivers a pep talk periodically about the value of investing. Unlike a private company, there is often no one scrutinizing plan costs on a regular basis, or asking the Plan Provider what due diligence they have gone through in selecting investments, or why there is a 7-year surrender charge for each contribution made to the plan. However, a church should not be free of the moral obligation to protect their employees' savings simply because it's difficult.

Here are some steps that can be taken by church leadership if they find themselves with a TSA plan that has been around since before anyone can remember:

1) Consider breaking away from the vendor-representative model. There are some salespeople who make an honest attempt to do the right thing regardless of whether a law compels them to do so. There are others who do not. Unfortunately, both types make their living in sales, so they will both seem like very nice people. If your sales representative has not made a suggestion in the last 4 or 5 years on how the church can save costs, view this as a warning flag.
2) Have an independent advisor review the plan and suggest alternatives. If lower cost alternatives exist and your current representative has not brought these to your attention, they are not playing on your side of the ball and probably don't deserve a second chance.
3) Talk to your plan administrator, or better yet, consult an independent 3rd party administrator who works with non-ERISA 401(k) plans and 403(b) plans. The administrator should be able to recommend plan providers they work with that can bring in proposals that are competitive and reflect the latest improvements in retirement plan design.

For more information on retirement plans or for a complementary review of an existing plan, please contact:

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