Trek Beyond To The Future of 401(k) Plans

By Ary Rosenbaum, Esq.

While I prefer Star Wars, I still have an affinity for Star Trek. Gene Roddenberry's vision of the future was a hopeful one while the science fiction genre prior to his tome had a bleak future. The original series and the series that followed include The Next Generation epitomize all of the wonderful and positive things that humanity can become. When it comes to 401(k) plans, I have hope for the future that features within the plans and changes in the regulatory environment will make the future as bright as Star Trek. By the way, 27 years later, William Shatner has never really atoned for Star Trek V: The New Frontier.

The Fee On The Edge Of Forever

When I started in the 401(k) business in 1998, it was a completely different world. While plan sponsors had a fiduciary duty to pay only reasonable costs, their plan providers had no requirement to fully disclose the fees they were collecting directly or indirectly from the plans they were working on. Third party administrators (TPAs) could have steered plan sponsors to revenue sharing paying mutual funds, pocket the revenue, and be under no requirement to tell plan sponsors what they were doing. Thanks to fee disclosure regulation in 2012, the days of wine and roses for some plan providers came to an end. Fee disclosures created a more competitive environment for some plan providers, which helped reduce fees industry wide. It also forced many providers including some major insurance companies (with heavy fee products) to get out of the retirement plan business. Thanks to the regulation and many thanks to litigation against some very large plans that bagged ERISA litigators some nice settlements, plan sponsors became more educated about their duty to pay only reasonable plan expenses. Many in the retirement plan industry were complaining that it would destroy the business because there would be a race to zero when it came to fees, only the cheapest plan providers would get business, and that plan sponsors would jettison plans because of the headaches in dealing with the regulations. Chicken Little was wrong and the sky didn't end up falling on retirement plans. Plan sponsors know that there is a cost for hiring plan providers and the only thing that it has done for the retirement plan business is make it more competitive and the companies that couldn't compete either sold off their business or left it entirely. It was a win-win. I believe that thanks to competition and thanks to better use of technology to automate retirement plan administration, the future will bring lower fees as it relates to a percentage of plan assets.

Where No Broker Has Gone Before

One of the biggest changes to retirement plans in the past 40 years is the Department of Labor's (DOL) decision to change the fiduciary rule and requires brokers who work on retirement plans to serve as fiduciaries. This is a huge fundamental change that will certainly impact 401(k) plans for many years to come. Why is this huge? I believe that it will level the playing field and it will curb some of the abuses that come with selecting plan investments. How will this level the playing field? Both brokers and registered investment advisors (RIAs) could work on retirement plans and call themselves retirement plan advisors. The huge difference is that an RIA is always a fiduciary, and until the new rule is implemented, a broker is not. As a plan fiduciary, an RIA has to watch the needs of the plan ahead of their financial need. That's why an RIA is paid a level fee; they don't make more money by suggesting specific investment options to be selected for the plan. A broker who doesn't serve as a fiduciary can make more money by pushing certain investments to plan sponsors as long as it's "suitable". Understanding how brokers are paid on investments is something even above my pay grade. There are many factors that go to broker compensation and it questions their advice in pushing specific investments. Thanks to the new fiduciary rule, brokers can recommend investments as long as it's in the client's "best interest". While people claim that the difference between suitability and best interest is only words, I believe

that it is a fundamental change because it will certainly give brokers pause for concern on what investments they should select. It will also eliminate expensive investments like certain forms of annuities that are just laden with fees. By holding brokers to the same standards that RIAs are held to will certainly lower fees as it pertains to the investment options of the plan. It will also add a level of accountability that brokers have been skirting for the past 40 years. Brokers serving in a fiduciary standard will create more responsibility and it will require broker-dealers to make sure that the brokers working on retirement plans are more careful and better prepared in dealing with the retirement plans they handle. There are certain brokers and broker-dealers that will decide to leave the retirement plan business if they have to serve in a fiduciary function. That may be true, but the bulk will remain because even as a fiduciary, working with retirement plans is a profitable business. There are many in the industry that will claim that the sky will fall with a new fiduciary rule, but they said the same thing with the fee disclosure regulation. The fiduciary rule will create more responsibility, accountability, eliminate more expensive investment options, lower fees, and have better educated retirement plan advisors. It's a win-win.

An Errand of Automatic Enrollment

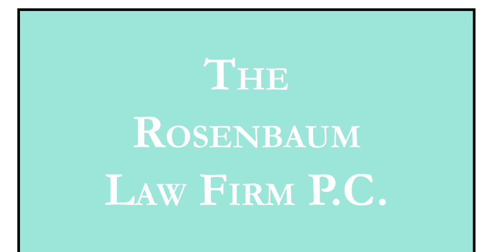
Automatic enrollment has only been a part of the Internal Revenue Code for the past 10 years and more plan sponsors have decided to add it. Why is this the future of 401(k) plans? Automatic enrollment gets plan participants who wouldn't have decided to defer their salary to save for retirement on their own. It also gives plan sponsors some liability protection by allowing plan sponsors to offer investments where these automatic deferrals can be deposited. It also helps plan sponsor with their compliance testing because it's assumed that the bulk of participants automatically enrolled are non-highly compensated employees. Automatic enrollment also helps increase plan assets which helps with plan costs since the costs of a plan as a percentage of assets decreases when the size of the plan's asset increased. More and more plans will be adding automatic enrollment to their plans because there really is no downside except maybe one or two employees irked that they were automatically enrolled because they forgot to opt-out. Otherwise, it's a complete win-win.

Day of the Delegated Fiduciary

There is so much talk of fiduciary duty these days, it's no surprise that there is a proliferation of plan providers willing to serve as a delegated fiduciary where they will assume the bulk of the liability that belongs to the plan sponsor. For example, there are RIAs that serve as an ERISA § 3(38) fiduciary where they maintain discretionary control of the fiduciary process. That means they select the investment options, they develop the investment policy statement, and they're responsible for educating plan participants. That means these §3(38)'s assume all the liability that goes with managing the fiduciary process. Many TPAs and other people including myself also assume the liability of the administration of the Plan by serving as an ERISA §3(16) administrator. These types of fiduciaries allow plan sponsors to delegate some of their duties as a plan fiduciary and the liability that goes with it. A plan sponsor can't fully eliminate all their liability in hiring these fiduciaries (they are still liable for hiring them), but it goes a long way in minimizing their liability exposure. That's why as we trek into the future, these types of fiduciaries are going to be more and more popular.

A Taste of Regulation and Litigation

The future for 401(k) plans will continue with increased regulations and increased litigation. Over the past 15 years, the DOL and the Internal Revenue Service (IRS) have been persistent in their oversight of retirement plans and many of their regulatory ideas have made it better to serve as a plan sponsor while also making sure that plan sponsors act more prudently (especially with fee disclosure regulations). Increased litigation by aggrieved plan participants and their creative ERISA litigators will also keep plan sponsors on their toes. The daily reporting of plan sponsors getting sued has had the effect of alerting other plan sponsors that they need to take better care of their plan. Increased regulation and litigation has created a better level of retirement plan providers who understand the significance of prudent fiduciary care and that eventually leads to better informed plan sponsors. 15 years ago, plan sponsors didn't know they were fiduciaries and didn't know the potential liability that comes with it. So the future will continue to have plan sponsors that are better informed than plan sponsors of the past.



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