401(k) Plans after Fee Disclosure

By Ary Rosenbaum, Esq.

Ever since the Department of Labor released retirement plan sponsor fee disclosure (Section 408(b)(2)) regulation that will finally take effect on July 1, 2012, people have been wondering how this will change the 401(k) industry. For those who believe in fee disclosure, they think these regulations are a gift from the almighty. For those who are against full fee disclosure, they think these regulations are a sign of Armageddon for the 401(k) industry. While we won't know how regulations will change the 401(k) industry until they actually take effect, we can guess what will happen, what won't happen, and what may happen after July 1, 2012.

What Will Happen

The 401(k) Plan Industry Will Survive

They are many Chicken Littles out there that claim that fee regulations will cause 401(k) plan terminations by employers and a depression in the deferral rates by 401(k) plan participants. The 401(k) industry has survived two great bear markets in the last, "lost" decade. It survived September 11th. It survived the change from annuity based, balance forward plans to the world of daily valued plans that is now dominated by the mutual fund industry. Fee disclosure is merely information and every 401(k) plan sponsor and participant should have the right to understand how much 401(k) plans cost them and whether their providers are charging a reasonable fee for the services they provide. 401(k) plans are still an attractive vehicle for retirement savings and it is hard to believe that many 401(k) participants will stop deferring thousands of dollars a year for their retirement savings because they no longer believe that the administration of their 401(k) plan is free. Don't believe Chicken Little, the 401(k) industry will survive in a world of fee disclosure.

Some will live, some will die, some will thrive

Many critics of full fee disclosure think that fee disclosure regulations will put may retirement plan providers out of business. Whether they are third party administration (TPA) firms, stock brokers, or registered investment advisors, these critics believe many of these service providers will be put out of business by fee disclosure regulations.

Whether it's the 401(k) business or any other industry, businesses have to adapt to changing times or die. Blockbuster Video is at death's door because they took too long to compete against Netflix. Montgomery Ward stores were closed because they were too slow to add stores to suburban shopping malls. Pan American World Airways failed because it could not adapt to a deregulated airline industry.

Like a good disaster movie (Poseidon Adventure), many retirement plan providers will survive and some will die. TPA firms and advisors that adopted fee transaparency before the call for fee disclosure regulations will thrive because they were ahead of the game. TPA firms and advisors who have hidden fees may have a tough time to survive, once fees are fully disclosed. The survival of every retirement plan provider after fee disclosure regulations take effect will depend on their ability to change with the times. They will either change with the times or the times will change them.

What May Happen

ETFs May Gain A Bigger Foothold In the Industry

Exchange traded funds (ETFs) have slowly been gaining market share in the 401(k) asset business. Their gain has been slow because the industry is still dominated by mutual fund companies, where the bulk of the daily no-transaction fee mutual fund trading platforms are owned by. These mutual fund companies have very little to gain and more to lose if ETFs make large gains in the 401(k) asset business. One of ETFs' biggest negatives in 401(k) plans is its fee transparency. Since an ETF has small management fees and pays no revenue sharing to offset plan administration fees, its transparency is actually a hindrance because people assume mutual funds cost less. With fee disclosure, one might imagine that an ETFs' transparent fee will now look more attractive than the transparent fees of mutual funds and the revenue sharing fees that are paid to plan providers whether they are sub t/a fee or 12(b)(1) fees.

It is quite possible that ETFs will get bigger distribution in a world of full fee disclosure. Once can hope, because competition is good and good competition has the effect of lowering prices for consumers.

Fee Disclosure May Increase Plan Sponsor Liability

One of the major industry booms in a hidden fee world of 401(k) plans has been in the legal professions when it comes to litigation against plan sponsors and plan providers. As we all should know, plan sponsors and the trustees of a 401(k) plan have a fiduciary responsibility to determine whether the costs in administering the plan is reasonable for the services provided. In a world of hidden fees, this is nearly impossible when the plan providers are under no legal requirement to provide the plan sponsor with a full disclosure of fees. Therefore, plan sponsors are subject to liability for fees they are unaware of.

One would think that fee disclosure regulations will minimize liability because plan sponsors will know the cost of their plan's administration. I think the opposite may happen. Many plan sponsors have ignored complaints from their participants and queries from plan providers trying to solicit business that their plan administration fees are too high. I suspect that even after they are given a full disclosure of fees, these same plan sponsors will still show no interest. Plan participants will also be given a full disclosure of fees by the plan sponsors, provided by plan providers by September 1. Since plan participants will be given full access to the fees being charged to their 401(k) account in 2012, one would suspect that may trigger more lawsuits because sometimes, knowledge can be a bad thing.

With a full disclosure of plan administration fees, plan sponsors will have to be more vigilant in determining whether their plan providers are charging a reasonable fee for the services provided. Since many plan sponsors have shown a lack of interest in their fiduciary responsibility up until now, one would suspect that they will carry this indifference after the implementation of those regulations on June 1. When handed a full menu of administration fees, indifferent plan sponsors will have less excuses to make why they didn't inquire to determine whether their plan's costs were reasonable after being sued by plan participants. I urge all retirement plan sponsors to annually review their fees and inquire other plan providers on their fees to determine what they are currently paying is reasonable.

What Won't Happen

All Plan Sponsors Will Not Flock To the Lowest Cost Providers

Many of the critics of fee disclosure claim that after the regulations are implemented, plan sponsors will only flock to the plan providers who perform services at the lowest cost. While cost will be a concern after full disclosure, it won't be the only reason that a plan sponsor will choose a provider. There are many low cost providers that offer many services at a low fee, there are some that offer bare bone services at a low price, and there are some low cost providers that aren't very good and are low cost for a reason.

Twelve years ago, I initially started my firm on the side to gauge whether I could start my own law practice. I based my business model in offering low cost, legal services. The idea flopped because when it came time to retaining a lawyer, low cost was never a concern. People seeking legal services want competency over cost and probably don't think being the Wal-Mart of legal services is an attractive path for a law firm. If cost was the only concern, all chain and department stores would be named Wal-Mart and every restaurant would be Taco Bell (like in the movie Demolition Man). The reason that every store isn't a Wal-Mart is because low cost isn't always the most important thing. While plan sponsors may have greater interest in low cost providers, there are other factors that determine who they will choose for a plan provider. Performance, technology, and competency are other considerations in addition to cost. While lost cost providers may gain business after the regulations take effect, they will not be the only game in town.

Fee Disclosure Won't Completely Fix 401(k) Plans

Hidden fees and an employer's belief in the myth of free 401(k) administration are part of the problems that ail 401(k) plans; they are not all of the problems. So while fee disclosure regulations will clean up the hidden fee issue, it still leaves many of the problems of 401(k) plans there. Fee disclosure regulations won't cure the problem of the lack of investment education provided to participants or a breach of fiduciary responsibility or the incompetent services provided by poorly trained TPAs, ERISA attorneys, and advisors. It won't increase the deferral rates of participants and it won't solve the retirement crisis that our country is experiencing. Fee disclosure will be a good first step towards fixing the problems of 401(k) plans, but it won't be a magic cure.

Whether you talk to a supporter or critic of retirement plan fee disclosure, you may think that the regulations will be heaven or hell on Earth. I think it will be neither. I think it will be a good thing for the 401(k) industry in the long run and will shall see what happens after it comes into play.

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