401(k) Plans Are Just A Tool To Save, They're Not Evil

By Ary Rosenbaum, Esq.

Years ago B.K. (before kids), I took weekly golf lessons. While it never showed on the golf course, I was developing a nice game. I took lessons with a curmudgeon golf pro named Kenny and the lessons were at a golf store. While I was salivating at the prospect of buying my own Callaway clubs, Kenny was insistent that a golf club was just a tool and it was dependent on how you use it. A golf club never makes the swing, the golfer does. So the newest Callaway and Titleist will slice pretty much the same way as a 50-year-old set of clubs if the golfer slices. While many television programs bemoan the fact that 401(k) plans are awful, the fact is that a 401(k) plan is merely a tool; it is dependent on how the plan sponsors and providers use it. So this article is a defense of 401(k) plans and how its usefulness is dependent on plan sponsors and their plan providers.

401(k) plans are not evil and they didn't kill pension plans

Frontline had a terrific program about 401(k) plans and Thomas Friedman had a not very good article in the New York Times as a result of the PBS program. Both Frontline and Thomas Friedman bemoaned how the great old defined benefit pension plan had been replaced by the 401(k) plan. Many people believe that 401(k) plans are responsible for the death of defined benefit plans. First off, defined benefit plans are being phased out, even for public sector and union employees (where one of the greatest benefits was a pension). It reminds me when Rick Pitino was the coach of the Boston Celtics. Coaching a young team that he never made winners of, he stated: "Larry Bird is not walking through that door, fans. Kevin McHale is not walking through that door, and Robert Parish is not walking through that door. And if you expect them to walk through that door, they're going to be gray and old." Defined benefit plans are not coming back in style, much like the leisure suit I had when I was 6. While the proliferation of 401(k) plans became popular when defined benefit plans were being phased out, pensions were doomed by poor market returns, historically low interest rates, the Tax Reform Act of 1986 which restricted the benefits of highly compensated employees, longer life expectancies, and the fact that Congress made it easier for companies to jettison them.

A lot of employers forget, a 401(k) plan is an employee benefit

Too often, employers forget why they put in a 401(k) plan in the first place. Much like health insurance and free coffee in the office kitchen, a 401(k) plan is an employee benefit. As an employee benefit, it's supposed to help with employee recruitment and retention. Unfortunately, many employers treat this employee benefit like the proverbial redheaded stepchild. The problem is that unlike the free coffee and the discount gym membership, neglecting this employee benefit is done at the plan sponsor's risk. Plan sponsors get sued or penalized by the government for poorly run 401(k) plans, they don't get sued for failing to provide milk for the free coffee they offer employees. In addition, it's amazing how so many of the decision makers for an employer's 401(k) plan have absolutely no care what goes on when it's their retirement savings in the plan. When I was at a law firm and was told by the trustees that the plan had no financial advisor, investment policy statement (IPS) and didn't review the investment lineup for 10 years, I advised them to change their act because I had skin in the game. A better 401(k) plan was better for me and for my retirement savings. So employers need to understand that a poorly operated retirement plan is not a good employee benefit, it can hurt employee retention and recruitment, it can be a potential liability pitfall, and the decision makers in the plan have their retirement savings there. While many plan sponsors scoff at the possibility they can get in trouble for their 401(k) plan, it only takes one aggrieved participant to cause enough problems for the plan sponsor. So an employer needs to be more interested in the handling of their 401(k) plan.

Diligent employers don't have bad 401(k) plans

While much of the criticism of the 401(k) plan industry is directed at the conflicts of interests that exist among many plan providers, the criticism gives short shrift to what I think is the responsibility

of the employer as plan sponsor. Let's face facts, a bank robber is going to go for the easy score of the local bank with no armed guard, they are not going to knock off the local Federal Reserve. Plan sponsors who take their role seriously and surround themselves with plan providers that are full of competence and empty of conflicts of interest are going to have plans that are better that the ones where the plan sponsors are asleep at the wheel. Again, going back to the golf club example, a diligent plan sponsor is going to know how to use a 401(k) plan like knowing how to swing a golf club and it's the plan providers that are going to help plan sponsors know how to use them efficiently (just like a golf pro like Kenny helped me). Efficiency when it comes to a 401(k) plan is trying to maximize employee participation, maximize tax savings through plan design, educating plan participants or giving them investment advice, and paying reasonable plan expenses in light of the services provided. What does it take to be diligent as a plan sponsor? Understanding their role and responsibility in the process such as reviewing plan expenses, reviewing their plan providers, reviewing the investments in the plan on a timely basis, and giving participants enough background in order to make informed investment decisions.

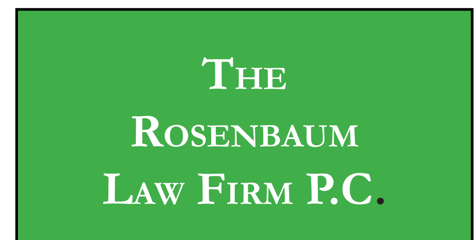
What's wrong with 401(k) plans isn't just fees, uninformed participants is a big reason

Much of the criticism of 401(k) plans over the past 5 years is targeted towards excess fees, especially mutual fund expense ratios. Much of the Frontline program was about fees and huge fees are a big concern because they take such a huge chunk of what a worker could have at retirement. The problem is that I am convinced that even if plan sponsors selected less expensive index funds as championed by the great John Bogle, you are still going to have major problems with 401(k) plans. The one major problem with 401(k) plans that the Frontline program gave short shrift to and what many in the media neglect is that the biggest problems affecting with 401(k) plans is when they went from annually valued, trustee directed plans to daily, participant directed 401(k) plans. The idea behind participant directed plans is that ERISA §404(c) is supposed to limit a plan sponsor's liability in losses sustained by plan participants when they direct plan investments. The problem is that most plan sponsors aren't aware that this liability protection is not a blank check or a suicide pact, their liability is dependent on whether they give plan participants enough information to make informed investment decisions. Participant directed 401(k) plans gave the least competent person to make investment decisions, the plan participant and most plan sponsors haven't given them enough information to make competent investment decisions. A good 401(k) plan is dependent on plan sponsors giving meaningful investment education and/or investment advice to their plan participants. Plan sponsors need to understand that providing this education and/or this advice to plan participants makes them good employers concerned about their employees' retirement savings, but more importantly, it helps limit their liability. Plan participants who receive education have a better than 3% annual return than participants who received no education. As the Eagles would say, that's a lot of money over "The Long Run." Plan participants who have better rates of return in their 401(k) investments are less likely to sue than those who have lousy returns. The problem is that too many 401(k) plan sponsors threw plan participants into the "investment decision making waters" without any flotation device. So too many plan participants are sinking and not earning enough in their investment returns for retirement.

Knowing what their providers do.

My wife jokingly states to people that she doesn't know what I do; at least I think she's joking. Seriously, plan sponsors need to understand what functions and what roles their providers do. They need to know which plan providers take on a fiduciary role and what their liability exposure is as a plan sponsor. Plan sponsors need to understand what fees that their plan providers charge and need to make sure that these fees are reasonable for the services provided. The caveat is that plan sponsors shouldn't just concentrate on plan fees because they have the right to pay more in expenses if they get more in services from their provider. Concentrating too much on fees may make the plan sponsor make an unwise change to a provider who offers less in services to reflect the low cost. If their current plan providers are providing more in services than the low cost providers, plan sponsors need to know that in order to make informed evaluations of their plan expenses.

It is easy to blame an inanimate object like a 401(k) plan for the trouble with retirement savings, but it is far harder to comment that whether a 401(k) plan is good or not is dependent on the plan sponsor using it. Plan sponsors who understand their role and duty will have much better 401(k) plans than those who don't. Just like a golf club, it's about how a plan sponsor uses it.



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