Plan Sponsors Need To Deal With A Whole New 401(k) World

By Ary Rosenbaum, Esq.

I've been an ERISA attorney for over 19 years and 401(k) plans have dramatically changed because of law changes, technological change, and changes in the marketplace. The problem is that most plan sponsors are stuck back in time when the courts and the government made it impossible for them to be sued or penalized. Business practices that were legal back then have been either eliminated or curbed because the courts and the Department of Labor (DOL) have frowned on them. What was good then isn't what's good now. Retirement plan sponsors need to understand the increased potential liability as plan fiduciaries and the best way to understand the changes that have taken place in the 401(k) plan business over the last 20 years. This article will let 401(k) plan sponsors understand how and why they need to be more vigilant in their role as a 401(k) plan fiduciary.

The change in technology

One of the biggest changes for 401(k) plans is because of technological breakthroughs. When I was enrolled in my first 401(k) plan in 2000, the plan had a website that only showed account balances. Even though it was daily valued and provided web access through their "SmartPlan" (it was down so many times that people called it DumbPlan), any investment decisions and changes had to be done through paper enrollment changes or by telephone. Now everything can be done pretty much through a smartphone and when I started working in 1998, I remember a BellAtlantic sales call telling me that digital cell phones didn't catch on yet and wanted to sell me an analog cell phone (I'm sure many of you don't remember that). It's just truly amazing how technology has made participating in 401(k) plans that much easier than in years past. Investment changes, deferral changes, and distribution requests can be easily made by the click of a button. Plan participants can even get investment advice online. This technology does come out of a cost to the plan providers to set up this infrastructure, but automation does cut down costs and limits human error. I can recall how many errors were made in deferral changes and distribution requests when it was done with good old paper and an inexperienced third party administrator (TPA) employee.

The focus on fees

Whenever the stock market goes south, there's a focus on people losing money in their 401(k) accounts. When there is a focus on 401(k) account balances, reporters would always talk about 401(k) plan fees and how they were poorly understood and not readily identifiable to plan sponsors and plan participants. Plan sponsors had no identifiable list of fees that the plan was paying and that was a problem when their fiduciary duty required them to pay only reasonable plan expenses. How can one know if fees were reasonable when their plan providers weren't required to tell plan sponsors what those fees were? Since the period of time since 2000 included two severe stock market meltdowns, the demand that there be some type of fee disclosure to plan sponsor and participants were able to withstand political pressure to stop it. Congress through the work of Representative George Miller tried legislation to

force 401(k) fee disclosure but contributions and pressure from Wall Street and the mutual fund companies stopped it. The DOL doesn't have to worry about election and fundraising, so they implemented mandatory fee disclosure regulations after much delay and debate.

Litigation against plan sponsors intensifies

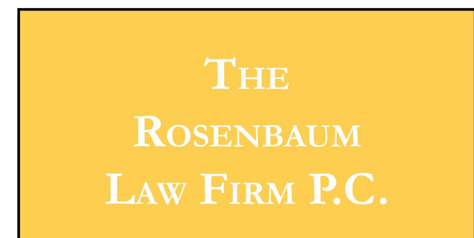
Plan participants lost money in their 401(k) accounts and they need someone to blame and ERISA litigators were happy to accommodate them by suing their employers. Much of the litigation was dealing with 401(k) plan costs since it's easier to provide damage through class action litigation. I remember the first class-action lawsuit dealing with revenue sharing funds used in 401(k) plans and plan providers and employers started winning these cases. However, time has changed court opinions on plan expenses and they have been on the side of plan participants for the past 10 years, The Supreme Court has made it easier for 401(k) plan participants to sue employers directly. Courts have even found plan sponsors to be violating a duty of prudence by using retail share classes of mutual funds when institutional (and less expensive) share classes were available from the very same mutual funds. Courts have also ruled against employers who based most of their selection of mutual funds based on the fact that these funds pay a revenue sharing fee to TPAs to defray plan administrative expenses. Courts have far less sympathy for plan sponsor the way they did 15-25 years ago. Courts have finally grasped the idea of a plan sponsor's fiduciary duty in running their plans and the need for plan sponsors to exercise that duty prudently.

The impact of fee disclosure regulations

Many plan providers and mutual fund companies were vehemently opposed to fee disclosure regulations because they insisted that the complexity would force retirement plan sponsors to abandon plan sponsorship because of the increased diligence they needed to exert. They also insisted that fee disclosure regulations would create a "race to the bottom" where plan sponsors would only select plan providers that charged the lowest fees. Well, Chicken Little was wrong with fee disclosure regulations and the sky did not fall. Plan sponsors did not jettison their retirement plans in mass protest of the regulations and there was no race to the bottom. Administrative costs for retirement plans went down as a percentage of assets and I don't believe that it was as a result of any race to the bottom. Much of the decrease in costs can be attributed to competition. Many plan providers such as bundled insurance companies slashed their fees because they understood that those fees were not competitive when plan sponsors would benchmark them. Technology has probably lowered plan costs, but the margins have shrunk because fees are more transparent. Plan providers who made hand over fist in fees slashed fees to remain competitive or left the business or died. The retirement plan business did not end when fee disclosure regulations were implemented, it thrived.

Investment Education/Advice Emphasized

Most of the time that I was enrolled in a 401(k) plan sponsored by the employer I worked for, there was little guidance. While there was a plan education meeting or two, most of the education that a plan sponsor would provide was the Morningstar profiles of the funds in the plan. The problem is that most plan participants aren't well educated in investments that may lead to poor investment results. The problem is that ERISA §404(c) will only limit a plan sponsor's liability for the investment losses under a participant's investment direction if plan participants have enough information to make informed investment decisions. So if a participant can only get a Morningstar profile of funds to make investment decisions, it's likely that a plan sponsor will still be liable for the investment losses incurred by plan participants. The DOL know how important investment education and advice is, that's why they implemented investment advice regulations that allowed plan providers to finally offer it. While there are fee and auditing requirements for providers who want to abide by it, it's proof that the government is serious that plan participants can get advice. Even plan sponsors understand that especially when they find out that there are providers like rj20.com that can offer advice if their other providers can't. The days where a plan sponsor gives little in investment education to plan participants is over.



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