Retirement Plan Features That Are Going Obsolete

By Ary Rosenbaum, Esq.

I've only been on this planet for about 40+ years and I'm always amazed at the technological advancements during my lifetime. I've seen especially amazed when talking to my 9-year-old daughter who thinks the IPad has been around forever. I've even seen technological breakthroughs like compact discs and fax machines essentially become obsolete even though I still think the technology behind it is amazing. I've been around the retirement plan business for 17 years and there are tons of things that have become obsolete or will become obsolete. So this article is about things associated with retirement plans that have or will become obsolete.

The Barney Fife Financial Advisor

What is a Barney Fife advisor? Well, it's a term I created. Barney Fife was the deputy sheriff on The Andy Griffith Show. The only bullet that Barney carried was always in his shirt pocket. A Barney Fife financial advisor is someone who only handles one retirement plan. The days where a financial advisor can have one retirement plan on their books are long gone. Financial advisors who dibble in the retirement plan space are doing their clients a disservice. Retirement plans and the rules regarding them have become more complex, so there really is no more room for people who don't have the requisite background to handle retirement plans. The issues regarding fiduciary oversight and plan costs require that retirement plans be handled by financial advisors that have the experience in dealing with these issues. Advisors that only handle one plan because it was done as a courtesy to a private management client who owns a business is not a courtesy to the plan sponsor and plan participants when their advisor doesn't have the experience to properly handle it. The sophisticated rules in a changing retirement plan marketplace require sophisticated and educated retirement plan advisors; there is no room for amateurs and those who want to dabble.

The Milk Carton Advisor

What's a milk carton advisor? It's a term I created for the financial advisor who the retirement plan client hasn't seen so long that she put the picture of the advisor on a milk carton. The days where a financial advisor can have a book of business and neglect their retirement plan clients are over. From a fiduciary standpoint, the retirement plan sponsor needs an advisor to guide them and show up semi-annually or quarterly to advise them. I've seen too many retirement plans with fund lineups of mutual fund dogs because the advisor never bothered to service the plan. I've seen too many retirement plans without an investment policy statement (IPS) because the financial advisor didn't bother to help the plan sponsor prepare one. The days where a financial advisor could have a book of business that paid their commission or fees quarterly without actually servicing the plan is over. Concerns by the Department of Labor (DOL), the Internal Revenue Service (IRS), and ERISA litigators have made the fiduciary process a heavy priority. So a financial advisor that doesn't actually help the plan sponsor in managing the fiduciary process is completely obsolete.

Revenue Sharing Paying Funds

While they are not obsolete, revenue sharing paying funds are going obsolete. What's a revenue sharing paying mutual fund? It's a mutual fund that forwards money to the retirement plan's third party administrator (TPA) to help defray plan expenses. I've never been a fan of revenue sharing paying funds and never will. Why? I think it's something akin to the practice of payola, where radio stations were paid by the record companies to play certain records. Revenue sharing is akin to payola because only certain mutual funds pay them and plan sponsors were encouraged by their advisor and TPA to select revenue shar-

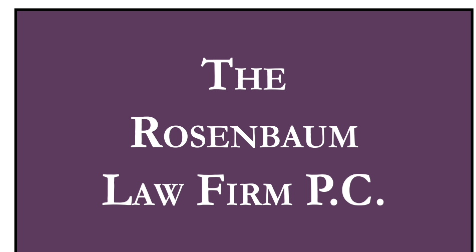
ing funds because of the appearance that revenue sharing would actually reduce plan expenses. The reason it was an appearance was because the revenue sharing payment came out of the mutual funds' management expenses. Index mutual funds never pay revenue sharing payments because their administrative expenses are so low that they can't afford to pay the 15-25 basis points that revenue sharing funds may pay. Mutual funds management expenses used to always be the hidden cost of retirement plans because this was a fee that the plan sponsor and their plan providers neglected to consider. Fund management expenses are a cost and higher fund costs eat into a plan participant's rate of return. While fund expenses were often neglected, ERISA litigators picked up on the idea that they were a problem and sued plan sponsors for that. In a landmark case called Tibble v. Edison, the court found that a plan sponsor violated their fiduciary duty of prudence because they used retail share fund classes when less expenses institutional share classes were available of the very same funds. Further cases have held plan sponsors to have violated their fiduciary duty if they based their selection of plan investment options based on whether they paid revenue sharing or not. That's why many plan sponsors and their advisors now try to select mutual funds that don't pay revenue sharing because they don't want the headache of trying to justify their selection of funds and proffer an overriding reason for fund selection than that they just pay revenue sharing. I always think that revenue sharing is essentially a shell game. While the plan sponsors thinks they are saving money in administration costs, they are paying for that revenue sharing by selecting more expensive mutual funds just because they pay revenue sharing. So selecting revenue sharing mutual funds is self-defeating because the savings are illusory when the participants pay more in investment expenses.

Money purchase plans

Money purchase plans are defined contribution plans with pension plan twists. The plan offers a set contribution each year that requires annual funding and there are annuity distribution requirements like defined benefit plans. They were popular when they were part of a "paired plan" when combined with a profit sharing plan. The reason for the paired plans was because there used to be an employer tax deductibility limit of 15% of plan participant compensation for profit sharing plans. So plan sponsors would offer a 10% contribution money purchase plan and a profit sharing plan where they had discretion to make a 15% contribution. When the limit on profit sharing tax deduction was raised to 25% of compensation in 2002, that made most money purchase plans completely unnecessary. The few money purchase plans that are left are usually reserved for union plans and employers that have some business reason for still keeping a money purchase plan.

Defined benefit plans for employers with employees

It's the original retirement plan and the defined benefit plan still gives the best bang for the buck in terms of saving for retirement plan. That's why it's the best retirement plans for sole proprietors or businesses that only employ spouses. Thanks to the proliferation of 401(k) plans and the need to trim expenses and manage costs, defined benefit plans for employers with actual employees is going the way of the 8 track tape. Employers shift to 401(k) plans because they shift the bulk of funding retirement from their responsibility to the responsibility of the plan participants when they switch to a 401(k) plan. In addition, Internal Revenue Code changes that were supposed to help underfunded defined benefit plans had the unintended effect of employers deciding to terminate their retirement plans. The problems with defined benefit funding has always been that funding costs go up when the stock market is bad (and when business for the employer is usually bad) and goes down when the markets are good (and when the employer is usually flush with cash). Since funding requirements are not consistent thanks to the market and demographic changes, a defined benefit plan doesn't give the costs certainty that a 401(k) plan has. Many defined benefits sponsored by employers that have employees are so because they are contractually required to provide one (like a unionized employer), they are very wealthy, or their plan providers never told them how prohibitively costly they are. Despite how obsolete they may seem, just like bellbottoms, there will still always be a market for a defined benefit plan.



Copyright, 2015. The Rosenbaum Law Firm P.C.
All rights reserved.
Attorney Advertising. Prior results do not guarantee similar outcome.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw