How 401(k) Plan Sponsors Can Improve Their Odds In "The Retirement Gamble"

By Ary Rosenbaum, Esq.

PBS' Frontline had a scathing report on 401(k) plans called "The Retirement Gamble". The Retirement Gamble had no roulette tables or free drinks; it was a rather sobering look at the troubles affecting 401(k) plan and employees who participate in them. Like most exposes, the Retirement Gamble had plenty of accusations and very little advice on how plan sponsors could improve their odds, which helps the retirement savings of their employees and limits their liability. So this article is how plan sponsors can improve their odds in the retirement gamble.

Be Vigilant and Awake

The fact is that most of the trouble with the 401(k) industry is that many plan sponsors are asleep at the wheel. The problem is two fold. First, the retirement plan sponsors are plan fiduciaries and are always on the hook for liability. Second, if plan sponsors don't care about their responsibility and potential liability, who else will? Fiduciary responsibilities include: acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them; carrying out their duties prudently; following the plan documents (unless inconsistent with ERISA); diversifying plan investments; and paying only reasonable plan expenses. So that is why plan sponsors need to be on top of their game and can't afford to be asleep at the wheel. Just delegating their work to their retirement plan sponsors and calling it a day isn't going to work. Retirement plan providers should be annually reviewed for both fees and competence. Plan sponsors also need to review their plan design to make sure it fits their needs. The fact is that too many 401(k) plan sponsors neglect their fiduciary duty, so that is why you have expensive plans with mediocre investment options and plan participants ill-prepared to pick their own investments. The Frontline program didn't want to point the finger at plan sponsors, but no one tries to rob a bank with a well-fortified safe, the easier score is to rob a bank where no one is watching it.

Making Plan Participants More Educated

While the Frontline program focused on conflicts of interests and high fees as the biggest issues regarding retirement plans, the major problem affecting 401(k) plans that the program almost completely ignored was the lack of education offered to plan participants. Most 401(k) plans are participant directed. The reason is that participant directed plans are supposed to relieve plan sponsors from liability under ERISA §404(c) for any losses incurred by plan participants when they exercise the investment control of their account balance. The problem is two fold. First, these plans put investment decisions in the hands of the people with the least amount of background to handle investment decisions, that being the plan participants. Second, plan sponsors assumed that giving plan participants investment control is all they had to do to enjoy the liability protection under ERISA §404(c). That assumption is wrong, plan sponsors need to make sure that plan participants can make informed investment decisions in order to get that liability protection. That means that plan sponsors need to make sure that plan participants are well informed. How to do that? At the very least, they need to make sure that plan participants receive investment education, which is a basic education about investing principals. They also should consider offering investment advice to plan participants which is advice based on the investment options in the plan tailored specific to each participant's situation. Investment advice can be offered by plan providers willing to abide by the new advice regulations or to hire another provider who will only offer advice as their service. Providers like rj20.com and Smart 401(k) can be offered to offer advice to plan participants utilizing the fund lineup you and your financial advisor have formulated.

Minimize the potential conflicts of interest

The retirement plan industry is littered

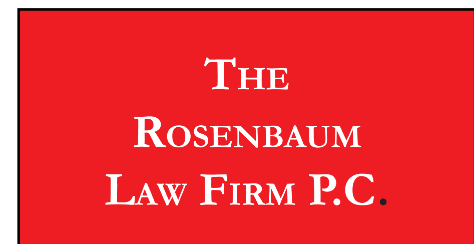
with potential conflict of interest. If exploited, these conflicts serve no one other than the providers themselves. With these conflicts of interests, the goal is not to provide plan sponsors clients with the best 401(k) plan out there, but to get the best pay for themselves. More than 75% of the retirement plan financial advisors out there are brokers and they currently owe no fiduciary duty to their plan sponsors clients, all they require is that the investments they offer are suitable. Registered investment advisors are the other 20-25% of financial advisors and they offer a fiduciary duty to their plan sponsor clients. A fiduciary duty is the highest duty in law and equity, so that means these financial advisors offer a fee for service that is not dependent on the investment options that they offer. Brokers get paid on the investment options offered in the plan and different mutual funds offer different trails (which is nomenclature in the business for payment). So the potential conflict there is that you may have a broker out there that maybe pushing funds that get them a better pay. The same can be said with third party administrators (TPAs) and plan custodians. If you utilize a 401(k) platform controlled by a mutual fund company or an insurance company, plan sponsors may be pushed to carrying their proprietary funds. Depending on the platform, the push to carry these proprietary funds may be a costly or poor performing proposal. In addition, there are unbundled TPAs that offer their own asset advisory business. The potential conflict of interest there is that the investment advisory arm may push plan sponsors to use revenue sharing paying funds that offers payments back to the TPA to pay down the administrative cost of the plan. The fact is that cheaper index funds don't offer really revenue sharing; only more expensive funds typically do because they can afford to offer the revenue sharing through their higher expense ratios. So again the potential conflict for a producing TPA is to push mutual funds that will help with their administration fee, so it looks like they are cheaper than a TPA where the advisor on the plan is using less expensive index funds that don't pay revenue sharing. So the industry is littered with potential conflicts of interest that unsavory plan providers can use to exploit. How can a plan sponsors minimize these potential conflicts of interests? Either by not having them by using a financial advisor that takes on a fiduciary status and a fully unbundled TPA or watching the providers like a hawk (which they are supposed to do anyway). A 401(k) plan that

is littered with conflicts of interest among their providers is an expensive plan that is not doing a good job for the plan sponsor and the plan participants; it's a recipe for disaster and a potential liability pitfall for the plan sponsor.

Outsource the fiduciary liability

While Frontline was grilling representatives from mutual fund companies, they neglected to mention the proliferation of retirement plan service providers who have developed fiduciary services where they assume the bulk of the liability from plan sponsors. There are financial advisors willing to be ERISA §3(38) fiduciaries where they assume the fiduciary process of the plan or full scope ERISA §3(21) fiduciaries that hire other service providers and effectively become the plan sponsor in responsibility. In addition, there are TPAs becoming ERISA §3(16) administrators where they become a named fiduciary and assume a good chunk of the liability that goes with the day-to-day administration of the plan. So if a plan sponsor isn't willing to accept the challenge of being a plan fiduciary, they can outsource a good chunk of the responsibilities and liability that go with it. Of course the liability that doesn't go with hiring these fiduciaries is hiring these fiduciaries, so plan sponsors need to monitor these providers to make sure they are doing their job and actually have the background to do it. In addition, any contracts with these providers need to be thoroughly reviewed to make sure that they are providing the services they promised as well as required for that level of fiduciary service. In addition, companies offering a fiduciary warranty are neither fiduciaries nor warranting something that they will actually have to pay out.

401(k) plans are not evil; they are merely a tool to save for retirement. Their effectiveness as a retirement savings vehicle for a plan sponsor's employees is dependent on how a plan sponsor will use it. The most effective 401(k) plans are the plans of employers that take the role of a plan sponsor seriously. The abuses of the 401(k) industry are only occurring when you have a retirement plan sponsor that is asleep at the wheel. A plan sponsor can improve their odds in the retirement gamble if they are merely awake at the gambling table.



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