The Plan Sponsor Awakens

By Ary Rosenbaum, Esq.

Like most of my generation, I have been a Star Wars fan since I first saw A New Hope when I was 5 in 1977. I even liked the prequel trilogy (except for Jar Jar Binks). When they announced that there would be an Episode VII, I was a little wary about a continuation of a story that had the perfect ending in Return of the Jedi. After two screenings of The Force Awakens, I can attest that the Star Wars I loved is back. Less special effects; more characters the audience can connect with. I loved the trailers and the ads for the movie especially with the voice of Supreme Leader Snoke asking Kylo Ren if he feels the awakening of the force. I have been an ERISA attorney since 1998 and the last few years there has been another awakening that many in the retirement plan industry have felt. The Plan Sponsor awakens; can you feel it? If not, you may after reading this article.

The Plan Sponsor usually was in a coma

When I started in the retirement plan business in 1998 as an ERISA attorney aligned with a Long Island based third party administrator (TPA), the industry was vastly different. There was so much talk about the growth of daily 401(k) plans where participants could make changes on the phone or if the website ever worked, the Internet. There was never talk about a plan sponsor's fiduciary responsibility or any real discussion on fees. Sure there was some discussion on fees like direct payments from the plan sponsor to the TPA, but not much talk about indirect payments made to the TPA by mutual fund companies. When the stock market was booming in the late 1990s and participants were making 30% annual returns, costs that could be as much as 300 basis points (3.0%) not including the management expenses if the mutual funds in the plan weren't a consideration. However, all good things come to an end.

When stock market crashes, people gripe about the 401(k) plan

When the stock market is booming, there is very little concern about how 401(k) plans are doing because they do well in rates of return when the stock market does well. Like clockwork, questions about whether a 401(k) plan is a proper retirement savings vehicle pop up when the stock market is going through a correction. I saw it with the dot bomb bust in 2000 and the aftermath of the attacks of September 11th as well as the credit crisis in 2008. When plan participants see their 401(k) account balances shrink by 40%, they start to panic and start laying blame. Articles would pop up on how plan participants were unprepared, how target date funds had too much equity exposure for those close to retirement, and there were articles on how costs in 401(k) administration were confusing. All of what these articles were stating was true, but the problems were always there whether the stock market was booming or not. The complaints only grew louder because people like to complain about things when they're losing money.

A perfect time to sue

ERISA litigators need to eat, like everyone else. When the stock markets went south, plan participants started to complain. Highlights of some of the hiding that went on with 401(k) plan fees got some ERISA litigators to think that there was some opportunity out there. So suing large companies with 401(k) plans for high plan fees became a burgeoning industry especially when the Supreme Court made it easier for plan participants to sue 401(k) plans in 2008. Plans were being sued for high administrative costs, lack of due diligence in selecting investment options, and holding plan sponsors to be responsible for not selecting lower costs options of the very same funds offered in the plan. While plan sponsors were winning in the initial lawsuits concerning revenue sharing, plan costs, and plan investments, the tide started to turn. It helped that the Department of Labor (DOL) woke up.

The DOL awakens

People forget that when it comes to retirement plans, there are two police units in place to make sure there is law and order out there. The Internal Revenue Service (IRS) is concentrated on making sure that retirement plans adhere to the Internal Revenue Code. The DOL is concentrated about protecting the rights of pan participants. Prior to the discussion of plan fees, the DOL was very good at investigating retirement plans that the plan sponsor embezzled from or getting a retirement benefit for employees that were being discriminated against from receiving one. When it came to issues regarding 401(k) plans, they tended to be a little silent. A California Congressman named George Miller started a movement to try to get Congress to pass legislation that would require retirement plan providers to divulge the true costs of administering a retirement plans to plan sponsors. It's still funny to note that before mandatory fee disclosure, there was no requirement that plan sponsors know the true cost of plan administration even though it was their duty to know what those costs are. While Miller was a Democrat, Democrats and Republicans could only agree one thing: take money from Wall Street. So Congressman Miller's campaign came up a little short when Wall Street influence put a stop to it. However, the DOL under Employee Benefit Security Administration honcho Phyllis Borzi decided to pick up the banner in the fight for fee disclosure. In a process that took years, the DOL implemented fee disclosure regulations that required plan providers to reveal all fees to plan sponsors and required plan sponsors to reveal fees to plan participants. Many in the industry indicated that plan sponsors would terminate their plans rather than deal with the new regulations and that plan sponsors would only hire the cheapest providers in some type of race to the bottom. Chicken little told them that the sky was falling, but the industry survived after the implementation of fee disclosure regulations. Some plan providers who thrived when the industry had fees cloaked didn't do so well, but most of the providers that practiced fee transparency did well for themselves. Fee disclosure was another impetus for plan sponsors to finally take their role as plan fiduciaries more seriously.

Plan Providers get more sophisticated

Not only did plan sponsors need to get more used to a changing regulatory landscape in the retirement plan industry, plan providers needed to as well and they did. With more litigation by plan participants and more involvement by the DOL, plan providers needed to better market themselves and offer new services to protect plan sponsors from liability threats. That's why many financial advisors offered ERISA §3(38) and ERISA §3(21) fiduciary services and why TPAs started offering ERISA §3(16) services. Typically, plan sponsors had hired retirement plan provider that they delegated authority as a third party while the plan sponsors still had the liability. ERISA fiduciary services such as §3(16) and §3(38) allowed plan sponsors to hire retirement plan providers and let those providers assume that liability. So rather than just working on plans, plan providers can shield plan sponsors from liability by assuming the liability that plan sponsors ordinarily have. By marketing these services, they actually ended up educating plan sponsors into seeking out such services and understanding the liability headaches that come with being a plan sponsor.

The conversation is continuing

As time continues, more and more concern about plan costs and liability has made it easier for plan providers and plan sponsors to have conversations concerning the sponsors' role as a plan fiduciary. Years ago, revenue sharing payments by mutual find companies to TPAs was the norm rather than the exception when it came time to paying the administrative costs of a daily valued 401(k) plans. Concerns over litigation against plan sponsors that used revenue sharing as a basis for selecting mutual funds in their Plan has helped seriously curtail the practice. As time continues, plan sponsors more and more have identified their potential liability and are seeking the providers that can help them minimize their risk.

THE ROSENBAUM LAW FIRM P.C.

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