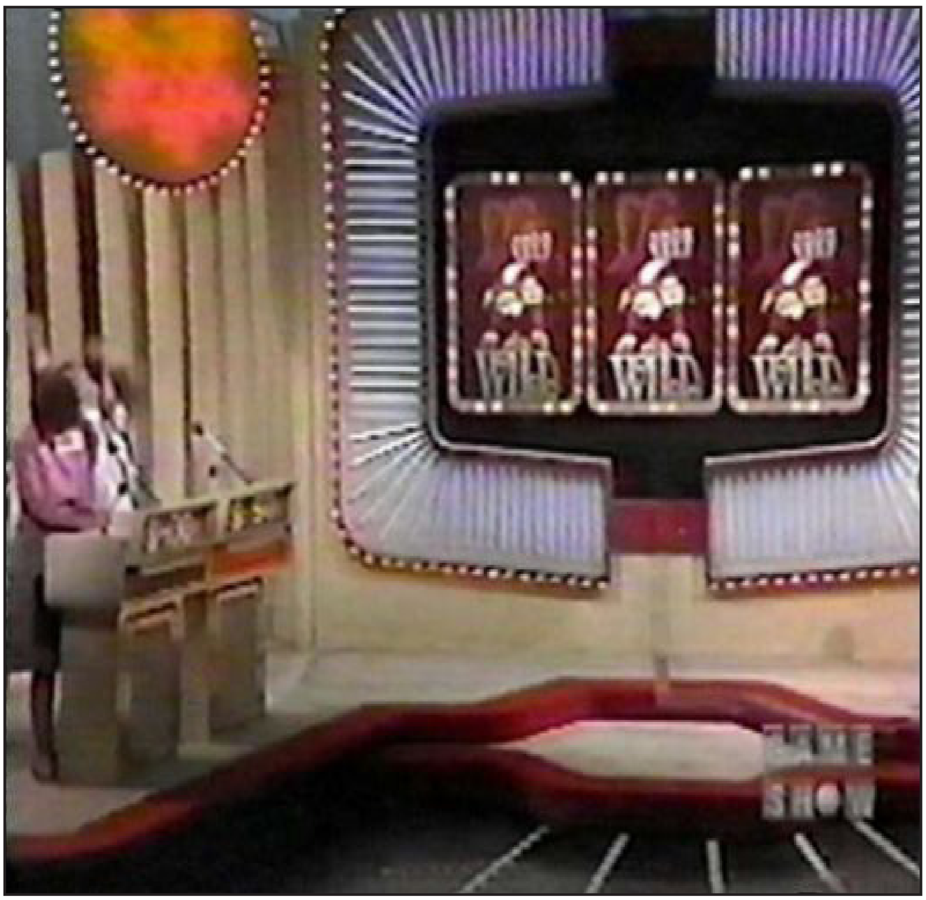
Why The 401(k) Fee Jokers Will Remain Wild

By Ary Rosenbaum, Esq.

When we were children, we were taught about fairy tales and the ending always seemed that they lived happily ever after. Unfortunately, life doesn't mirror fairy tales. Even noble ideas to fix problems won't totally cure them. That is why 401(k) fees that will be disclosed to plan sponsors in 2011 and participants in 2012 won't totally cure the problems of excessive fees. The plan providers whose nefarious practices created the need for 401(k) fee disclosure will find a way to mask their fees and I'm sure they have already found the loopholes within the regulations requiring fee disclosure to continue their treacherous ways.



The regulations that will require service providers after July to disclose fees to plan sponsors. The regulations were implemented to enable plan fiduciaries (such as the plan sponsor and plan trustees) to determine whether fees paid to retirement plan sponsors are reasonable. ERISA requires plan fiduciaries, when performing their duties (including selecting and monitoring service providers), to act prudently and solely in the interests of plan participants. To complete this task, the plan fiduciaries must have information sufficient to enable the fiduciaries to make informed decisions about the services and the service provider to determine whether the fees paid are reasonable for the services provided.

Under the regulations, information required to be disclosed by plan service providers must be furnished in writing to the plan fiduciary. Information that the service providers must disclose include a description of the services to be provided and all direct and indirect compensation to be received by the service provider, its affiliates or subcontractors. Direct compensation is compensation received directly from the plan. Indirect compensation generally is compensation received from any source other than the plan sponsor, the covered service provider, an affiliate or subcontractor.

The regulations include a class exemption to address situations in which a plan fiduciary discovers an error or deficiency in the service provider's disclosure. If the fiduciary "reasonably believed" that the service provider had disclosed the information required by the rule, relief is available by requesting in writing that the service provider furnishes the missing information within 90 days. If the service provider fails to comply with the fiduciary's request within 90 days, the fiduciary must notify the Department of Labor.

For 99.99% of the service providers out there in the retirement plan industry, they will comply with the disclosure regulations and divulge all the required information to plan fiduciaries. This will include bundled and unbundled providers from the very large insurance companies to the small third party administration (TPA) firms. While the very large majority of service providers are honest, there are a few 401(k) jokers who will treat the disclosure regulations as mere suggestions on how to approach their business.

Disclosure is only as good as the information that is disclosed and so many providers in the past have claimed to provide full fee disclosure when they really have been hiding the ball. The TPA that I left four years ago was a provider that proclaimed on their website that they practiced full fee disclosure. That practice at one point included the pocketing of revenue sharing and then when they started to disclose revenue sharing, they invented a fee that never existed before to justify the pocketing of revenue sharing. I am sure they would have devised a method to skirt the new disclosure rules if they were still in business.

How can the disclosure rules be skirted? Pretty simple. The disclosure regulations are based on an honor system that the plan provider will be forthcoming with the direct and indirect compensation they receive, as well as the fees they charge. What would happen if the plan provider would be less than forthcoming? If the plan provider won't truly be honest about the fees they are charging, who will know? Almost no one if the plan doesn't require an audit. For example, I represented a company that was having issues with their TPA who was also their registered investment advisor. The plan didn't require an audit and the plan sponsor was told that revenue sharing fees would be used to offset all fees and the only fees that would be charged would be the base fee and the per participant charge. A review of their trust statements disclosed that the TPA was getting paid a quarterly charge of $4,500 that the plan sponsor had no idea what it could be. I assumed that the TPA had lied to the plan sponsor and was pocketing the revenue sharing. The custodian of the plan's assets claimed they had no way of knowing what revenue sharing payments were paid by the mutual fund companies to the TPA. Since most of the funds were invested with one mutual fund company and I knew one of the vice presidents of that company, I was able to estimate that the TPA was making on average, 15 basis points in revenue sharing that they were pocketing. So even with fee disclosure regulations, what would stop a TPA like that to continue that practice? Barring a forensic accounting, nothing.

The TPAs that have been using reenue sharing payments from mutual fund companies to line their pockets instead of using it to offset fees may disclose the revenue sharing payments that they receive to plan sponsors, but they may try another tack to retrieve revenue sharing that they "lost" through fee disclosure. I have already been advised that there is a large TPA in New England that charges their clients 25 basis points for custodial fees that 401(k) custodians charge for their custody services and for their platform. The problem is that for a TPA of that size, custodial platform charges should be about 6 to 10 basis points, so it appears they are padding the charges that they are passing to their clients. The problem with that is

that it's actually perfectly legal since the fee is disclosed. For the few TPAs that pocketed revenue sharing, revenue sharing is an addiction that is hard to wean off of. So don't be surprised if these TPAs pad certain fees to offset any loss of revenue sharing.

Why should the plan sponsor care if their service provider is not fully disclosing their fees when required by the regulations? If the service provider fails to disclose the required information under this regulation, the responsible plan fiduciary will have violated their fiduciary duty because they caused the plan to engage in a prohibited transaction by hiring the service provider. The regulations do contain that procedure discussed above for obtaining relief for plan sponsors, who may have inadvertently entered into prohibited arrangements because the service providers have not given them the required information, but how would a plan sponsor know? If plan sponsors would do what they should be doing, taking the fees that were disclosed and shopping it around competing service providers to determine whether the fees they are paying are reasonable. The service providers that are the 401(k) fee jokers have only thrived when plan sponsors and fiduciaries sit in a vacuum and don't check whether the fees they are paying are reasonable. Fee disclosure regulations are a weapon against the service providers whose terrible behavior required their implementation. They can only be effective when used properly and that is to ensure that the disclosures are correct and the fees are reasonable, that can only be done if the plan sponsor does gauge what other similar service providers may charge.

This article is not to create a bogeyman that does not exist or instill fear about rogue service providers, but I worked at one that I'm sure would have found a way to get around it. Most service providers will abide by their requirements, but a very small minority of service providers won't abide or create new gimmicks from their bag of 401(k) fee tricks. The only weapon to prevent it is for the plan sponsors and fiduciaries to do their job properly.

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