Why Retirement Plan Providers Need to Stay Ahead of the Curve

By Ary Rosenbaum, Esq.

History is littered with formerly successful companies who didn't understand the change in their industry and fell by the wayside only to be succeeded by their competitors that did. Montgomery Ward was one of the largest national retailers, only to falter because unlike Sears, they didn't understand the change in the demographics in the country in the move to suburbia. Blockbuster Video, the most successful video rental company is on a slow way to oblivion because they didn't foresee the viability of DVD rent by mail and only offered that service 6 years after Netflix first did. Pan-Am was the most respected airline in history, but its prestige as the beacon of international travel couldn't survive in a deregulated airline industry where they had to compete with other carriers for international routes. These former business giants stumbled because they didn't stay ahead of the curve. In business, you have to stay ahead of the curve and be cognizant of the changes in your industry. As I always say, you have to either change with the times or the times will change you.

The retirement plan industry is a constantly changing business. Once dominated by trustee directed defined benefit plans, the retirement plan industry is now focused on participant directed 401(k) plans. Once riddled with hidden fees, plans sponsors will finally see the light and the fees they are being charged by their plan providers with fee disclosure coming in 2012. All retirement plan providers whether they are financial advisors, third party administration (TPA) firms, auditors, or ERISA attorneys must be aware of the changes within the retirement plan industry and get acclimated to it. If the provider fails to understand the changes or decides to be like Don Quixote and fight the tsunami of change, then they stand the risk of being forced out of the industry.

Fee Disclosure was inevitable as the Sun coming up

The rules regarding retirement plan costs created a type of paradox. While plan sponsors did not have a legal right to get disclosure of all fees from their plan providers, they were breaching their duty as plan fiduciaries if the plan expenses they were paying were not reasonable as compared to what was available in the marketplace. While the TPA's fees for non-401(k) plans were pretty straightforward (base fee and per participant charge), daily valued 401(k) plans were cloaked with fees that plan sponsors didn't understand that many TPAs didn't want to reveal. Whether it was a 12b1 fee, revenue sharing, sub t/a fee, wrap fee, or custodial fee, some TPAs were not very forthcoming about the reimbursements they received because they wanted to create the illusion that their expenses were much lower than what was in reality.

Four years ago, I remember having been asked by my boss at this TPA to read about the New York Attorney General's agreement with a New York state teacher's union and their endorsed 403(b) plan with an insurance company provider. As part of the agreement, the union and the insurance company agreed to fully disclose all fees in a fee menu to participants. After reading that agreement, I knew that fee disclosure was inevitable and my TPA would die in a fully disclosed fee environment because the bosses in charge were still treating as if the business was still in 1995 and pocketing revenue sharing or collecting 265 basis points on a $4 million 401(k) plan was OK. Full fee disclosure was inevitable because in what other industry are you not entitled to know how much you are being charged?

Just a year later as an attorney at a law firm, I put a client's 401(k) plan up for bid that was administered by my old TPA. I was surprised with how a majority of the TPAs putting in a proposal fully disclosed fees, years before they were required. The difference between the provider selected and my old TPA (when you add back in the revenue sharing they pocketed) was about 45% in administration expense savings using the same custodian, fund lineup, and broker. TPA firms that made fee disclosure part of their business years before it became necessary were ahead of the curve and are at an advantage that those who tried to fight it. There

is no point taking a stance against fee disclosure since plan sponsors and their advisors are demanding it. TPAs who think they can get away with an inflated custody charge or imaginary fees will be at a severe disadvantage when fee disclosure is finally implemented because a competing provider will certainly note to the client which fees are inflated and which don't exist. Even the insurance companies and mutual fund companies that have fought tooth and nail against fee disclosure have finally come around. All retirement plan providers must come to grips that fee disclosure will be here to stay and a provider must adjust their fees and expectations in light of the fact that fee disclosure may squeeze their pricing and margins if its implementation creates a price war.

The Definition of a Fiduciary

I always find it interesting that brokers and registered investment advisors (RIA) could both claim they are retirement plan advisors, help a plan sponsor draft an investment policy statement, select funds, educate participants, and collect a fee. The one difference is that the RIA has a fiduciary duty of care to the plan and the broker does not. The Department of Labor found that interesting as well and decided to update their definition of a fiduciary, especially since the retirement plan landscape has changed since 1974. Mutual funds weren't as popular in 1974, 401(k) plans didn't exist, and no one knew what a daily valued participant directed 401(k) platform was. The DOL has issued regulations that will put brokers and some TPAs on the same footing as RIAs as fiduciaries. While it seems that some Democrat and Republican lawmakers can only agree on one thing, that these regulations are terrible (Wall Street campaign contributions help), I believe there will be some change to the definition of a fiduciary.

For those advisors who are already are fiduciaries were already ahead of the curve. Some RIAs have gone farther ahead by opting to be ERISA §3(38) and §3(21) fiduciaries. If you are a broker/dealer, you have to prepare ahead that there will be limited change between what the DOL has proposed and what will be implemented. Broker dealers really have three options if the change to the definition of fiduciary is made: leave the retirement plan business, become a fiduciary, or team up with a ERISA §3(38) fiduciary where the brokers will be hired by the §3(38) fiduciary to handle the non-fiduciary function that a retirement plan advisor would handle such as plan enrollment and education. I have a number of ERISA §3(38) fiduciary clients already making agreements with small broker dealer firms to team up which is a great fit for both as the ERISA §3(38) fiduciary picks up new business and the broker-dealer remains in the retirement plan space without having to become a fiduciary.

Both brokers and RIAs should determine what steps they need to take in the event the change is going to be made to the fiduciary definition. There are several firms already ahead of the curve. The rest will have to play catch up, but options should be considered before that day of change comes.

Always Be Open For The Next Big Thing

Regardless of whether you are a TPA, financial advisor, ERISA attorney, or retirement plan auditor, you should always keep abreast of the changes in the retirement plan industry. It could be as simple as changes to the Internal Revenue Code, ERISA, or a new type of retirement plan investment.

As a provider, you should always be open to change. Whether its exchange traded funds (ETFs) in 401(k) plans or a new plan design like DB(K) or a new plan provision like automatic enrollment, you should keep an open mind to change. Sometimes change takes time or the change fails to materialize, but retirement plan providers should be aware of what is going on in the retirement plan industry. Financial advisors and TPAs don't have to start touting ETFs or index funds, but need to be aware of their growing penetration in the 401(k) market. They need to be open to new ideas, instead of trying to fight them. I'm sure there are quite a few 401(k) providers who went out of business because they were unwilling to entertain the notion of daily valued, participant directed 401(k) plans. I remember when automatic enrollment was finally codified into law and I suggested to the bosses at my old producing TPA that they should consider pushing automatic enrollment to grow assets and as part of a branding campaign. I'm still waiting to hear from them almost 6 years later. Plan providers should also listen to their clients and potential clients as well as their referral sources to determine what they want. Too many plan providers say no to these requests without determining whether they could be flexible. I have seen too many TPAs who are little too stubborn with the type of retirement plan advisors they will work with or the circumstances that they will take in new business. The most successful businesses are those that are open to change

Retirement plan providers need to be aware of change and be open to the possibilities. Certain regulatory changes will be implemented and retirement plan providers should have a battle plan in how they will respond to that change. Things that come to those who wait were left by those who got there first. It's better to be ahead of the curve that be behind it.

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