401(k) Plan Sponsors: It's Time To Wake Up

By Ary Rosenbaum, Esq.

Anytime I travel, I ask for a wake up call even though my IPhone will blare "Eat the Rich" by Aerosmith at the same time because you can never be too careful. When I travel around the country to speak, I want to make sure I don't sleep through my allotted time. When it comes to being a retirement plan sponsor, employers never had a wake up call about their fiduciary duty for years and now that there is one, many plan sponsors are still sleeping through it. So this article is about how the rules concerning retirement plans have changed and how 401(k) plan sponsors need to wake up and take notice of these changes.

The "Good Old Days" for retirement plan sponsors

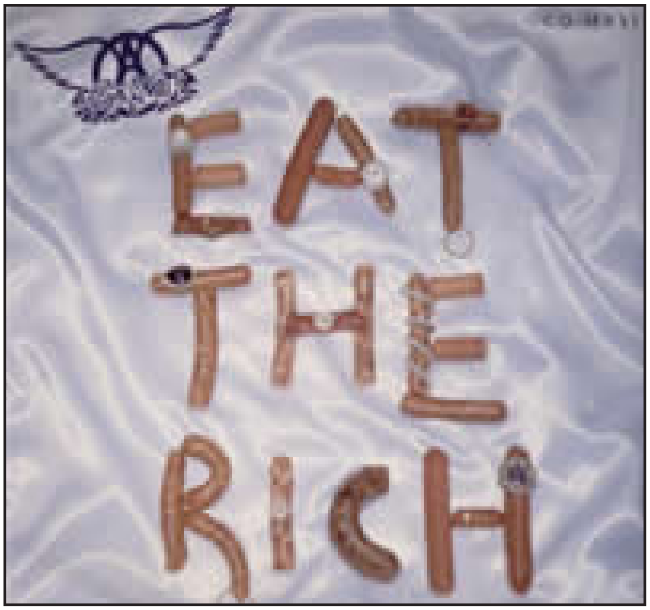
Often people talk about the good old days and they were hardly good at all. My aunt often reminisces about her younger days in Israel, forgetting that Israelis in the 1950's were being rationed in the food they could buy. Her memory is clouded by the fact that those days were when she was young and youth tends to play games with reality. Ask any child from the 1970's and 1980's who scream about the Star Wars prequels. When I started in the retirement plan industry in the late 1990's, I assume those might be considered the good old days, depending on whom you could talk to. In the "good old days", plan administrative fees were higher (as a percentage of assets), plan participants were having fantastic returns in their account balances, and plan sponsors rarely got in trouble for operating their retirement plans. As long as their plans were compliant with the Internal Revenue Code and ERISA, plan sponsors had nothing to fear, even fear itself.

Then the bottom fell out

Around 2000, the stock market was corrected, as the dot.com era became the dot.bomb era. Participants whose 401(k) accounts were getting annual 20 to 30% returns were now seeing their account balances dropping that much. With participants upset by their returns and ERISA litigators a little hungry, the first class action lawsuits regarding plan fees were showing up around them, but plan providers and sponsors were able to win those initial lawsuits. Concerns about plan expenses always come up when participant's returns turn negative so the litigation and concerns about plan fees went a little soft after the stock market's recovery after the September 11th attacks. However, the real estate bubble bursting and the credit crunch in 2008 had participants' accounts going south again. So the talk about plan fees picked up again, as well as litigation. The ERISA litigators got more novel and creative about their legal arguments especially when it came to revenue sharing arrangements where providers were getting payments for using certain mutual funds. These ERISA litigators started beating back motions for summary judgment, then they started winning because courts recognized that plan sponsors were truly breaching their fiduciary duty if they were not paying reasonable plan expenses which usually meant that plan participants' accounts were being soaked up in fees. The Catch 22 about plan expenses is that plan sponsors had a fiduciary duty to pay only reasonable plan expenses, but they didn't know the full extent of fees that their plans were paying because their plan providers weren't legally required to report their fees to their plan sponsors clients. That was going to change.

The Department of Labor wakes up

The Department of Labor (DOL) is the agency that enforces ERISA but until Phyllis Borzi took over as the head of DOL's Employee Benefit Security Administration (EBSA), they were a disinterested bystander when it came to a plan sponsor's fiduciary duty. The DOL was mainly interested in investigating plan sponsors that did absolute wrong to plan participants, but not about typical breaches of fiduciary duty. With Borzi in charge, the DOL became more forceful in making sure plan sponsors complied with their fiduciary



duty even looking on audit whether plan sponsors were doing their job in managing the fiduciary process, such as making sure they had an investment policy statement. So when dollars from Wall Street made Congress impotent in legislating retirement provider fee disclosure, the DOL implemented regulations that required disclosures to both plan sponsors and plan participants. Disclosure is just one small piece of fee disclosure, plan sponsors now had a greater emphasis in documenting their fiduciary duty to determine whether fees are reasonable or nor. Getting disclosures isn't enough; plan sponsors had now no excuse to not benchmark their fees. Plan sponsors who scoffed at concerns about plan fees because they claimed they were too small for the DOL to care, now started to wake up. The implementation of the DOL's fee disclosure regulations is just a wake up call; enforcement through random DOL audits has likely started and will likely grow. While I'm sure there are plan sponsors and providers who will claim that plan sponsors won't get into trouble for not complying with fee disclosures, the DOL will ramp up enforcement of these disclosures because random audits will be the only way to ensure voluntary compliance with these rules.

The right providers come through

As retirement plans have become more technical, thanks to fee disclosure, there have been a growing expertise among plan providers. The good old days when plan providers made hand over fist without providing the necessary help to plan sponsors is long gone. Brokers who never bothered to show up to a plan sponsor client every 6 moths or year were now competing against financial advisors who took on a greater fiduciary role at a fraction of their fee. Third party administrators who took revenue sharing payments without letting clients know had to pare down costs to compete against providers who were fully transparent. Plan sponsors need to identify their providers, identify their fiduciary role (if, any), and whether they have the sophistication in providing competent plan services at a reasonable cost.

More Litigation and More Setbacks for Plan Sponsors

The Supreme Court in LaRue v. DeWolff made it easier for individual plan participants to sue plan sponsors over their retirement plan. In Tibble v. Edison, a Federal court indicated that a plan sponsor had breached their fiduciary duty of prudence if the plan offered more expensive retail class shares of mutual funds when less expensive institutional share classes of the very same funds were available. Now plan sponsors could get in trouble for paying retail when they could have paid wholesale. While larger plans have been predominately the defendants in litigation, plan sponsors of all sizes are at risk now more than ever for failing to live up to their end of the bargain as a retirement plan fiduciary. Every day, we read about plan sponsors being sued such as plan providers and universities over the high fees in their plan.

The DOL is awake and penalizing plan sponsors.

In 2016, the DOL closed 2,002 civil investigations with 1,356 of those cases (67.7%) resulting in monetary results for plans or other corrective action. The DOL recovered $ 777.5 million for direct payment to plans, participants and beneficiaries. Since the DOL is just focused on civil penalties and actions, 96 people were indicted and 75 people either plead guilty or were convicted in connection with crimes revolving around retirement plans. So the DOL is certainly cracking the whip.

Now the auditors are looking

The purpose of an audit for a retirement plan that requires one (generally, those with 100 or more participants) is to ensure that the assets are where the plan sponsors and providers say there are, as well as to ensure that the assets will be there to pay off the participant's retirement benefits. So auditors are concerned about a plan sponsor's internal controls as well as any issues that threaten the tax qualification of the retirement plan. Most auditors were never interested in plan expenses of the plans they reviewed.

Well, things have changed and plan sponsors with audits have more work to do. One of my plan provider clients forwarded me a list of questions that one of their audit-required plan sponsor clients forwarded from their auditors. It was a litany of questions regarding fee disclosures; plan expenses, and whether the plan sponsor exercised their fiduciary duty in determining whether plan expenses are reasonable for the services provided. So if a plan sponsor did nothing about plan expenses and truthfully told their auditor of their malfeasance of fiduciary duty, I am sure that those responses will end up somehow in the audit report, which of course is filed with a Form 5500 that is readily available to the government and to the public.

So plan sponsors with an audit have some work to do to show their auditors on whether they are exercising their fiduciary duty in only paying reasonable plan expenses.

The days of wines and roses are over. Plan sponsors need to get serious about their fiduciary duty and surround themselves with the right plan providers. The threats to plan sponsors are real; I didn't make it up. Consider this article your wake up call.

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