401(k) Plan Sponsors, This Is Your Wakeup Call

By Ary Rosenbaum, Esq.

One of the great things about my iPhone is the alarm that serves as my wake-up call, whether at home or on the road. 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 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 frequently reminisces about her younger days in Israel, forgetting that Israelis in the 1950s were being rationed 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 1970s and 1980s who screams about the Star Wars prequels. When I started in the retirement plan industry in the late 1990s, I assumed 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. 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 about 15 years ago, 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 wrong to plan participants, but not about typical breaches of fiduciary duty. Since the Barrack Obama administration, the DOL became more forceful in making sure plan sponsors complied with their fiduciary duty even looking at audits 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 reason-

able 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 about, for 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 has been growing expertise among plan providers. The good old days when plan providers made hand over fist without providing the necessary help to plan sponsors are long gone. Brokers who never bothered to show up to a plan sponsor client every 6 months 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 fully transparent providers. 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 has 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.

The DOL is awake and penalizing plan sponsors

EBSA tallied its enforcement action for 2023. EBSA recovered $1.435 billion in direct payment to plans, participants, and beneficiaries in 2023. More than half of those recoveries were the result of enforcement actions, and more than 30 percent came from informal complaint resolutions. EBSA closed 731 civil investigations. Of those, 505 cases (69 percent) produced monetary results for plans or another form of corrective action. I assure you, you don't want to be on the opposite side of an EBSA action.

Now the auditors are looking

The purpose of an audit for a retirement plan that requires one (generally, those with 100 or more participants with account balances) is to ensure that the assets are where the plan sponsors and providers say they 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 the 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- how in the audit report, which of course is filed with a Form 5500 is readily available to the government and the public. So plan sponsors with an audit have some work to do to show their auditors whether they are exercising their fiduciary duty by 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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