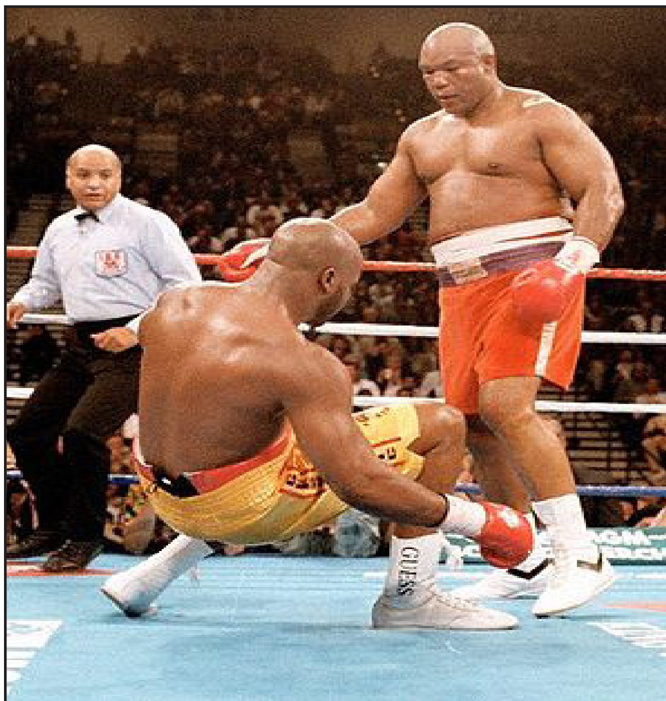
It Happened! Changes In The 401(k) Industry That Could Affect Your Plan

By Ary Rosenbaum, Esq.

I've been a boxing fan since I was a kid when Marvin Hagler, Larry Holmes, Aaron Pryor, Tommy Hearns, Sugar Ray Leonard, and Mike Tyson were the premier boxers. One of my favorite boxing moments was in 1994 when 45-year-old George Foreman won the heavyweight title of the world by knocking out Michael Moorer with one punch. As Moorer was counted out, Jim Lampley proclaimed: "it happened, it happened." Foreman was being beaten for 9 rounds, but Moorer made this mistake of standing right in front of Foreman. Like the idea of a 45-year-old regaining the world heavyweight title, there are a lot of things over the past 20 years that people said couldn't happen when it comes to retirement plans and it did. This is about changes in the retirement plan industry that happened that can affect your 401(k) plan.



Yeah, I like to be right

We all have our shortcomings and one of mine is loving the fact when I'm right. I've been an ERISA attorney for 19 years and when I made some predictions about the retirement plan business, I was laughed at. I thought the use of revenue sharing paying funds in 401(k) plans would be a problem, I thought there would be some sort of fee disclosure requirements one day, and I predicted that small plans would be sued. People in this business, especially former co-workers laughed at some of my predictions, yet like with Foreman beating Moorer, it happened.

Small plans do get sued

When I first started my own practice in 2010, I took the advice of Mike Alfred from Brightscope and contributed blog posts on LinkedIn. The blog posts lead to longer articles on JDSupra, which you're reading right now. I talked about the increase in 401(k) litigation thanks to a groundbreaking Supreme Court decision that made it easier for 401(k) participants to sue as well as upheaval in the markets where people were losing money in their 401(k) accounts. There was one contributor on LinkedIn who was very adamant that I was selling services based on fear because no small 401(k) plan was ever sued at that point. At the time, he was probably right. However, my rationale that smaller 401(k) plans can get sued was based on the idea that the increase in litigation and ease of participants being able to sue would make that a reality. So it happened! Over time, a handful of small to medium sized 401(k) plans have been sued. They aren't front page news items because the companies being sued aren't front page companies, the reality is that smaller plans are getting sued. The ERISA litigation market is going downmarket and pesky lawsuits from participants are a headache even if the plan sponsor did everything prudently and correctly. While the class action lawsuits are always going to be the domain of larger plans (more participants=more assets=more recovery for ERISA litigators), that won't stop aggrieved 401(k) plan participants and a vengeful former employee from considering filing a lawsuit against small and medium-sized companies. I believe you'll see an uptick in what I would call nuisance value 401(k) litigation where a former employee with an ax to grind for being terminated correctly would sue a former employer over its 401(k) plan to procure a quick, nuisance value settlement. I point that out because I'll never forget working with a former plan administrator who was terminated for cause (for lying about his work hours and days), then suing for religious discrimination so that he could get a quick $4,000 settlement. While assets of larger 401(k) plans mean that they're likelier targets, one should never discount that smaller plans will become bigger targets because it's an area of ERISA litigation that hasn't been fully exhausted and smaller plans tend to have larger issues regarding excessive fees and poor compliance. Larger plans may have larger assets than smaller 401(k) plans, but they have the same level of fiduciary duty to plan participants. That means that smaller 401(k) plan sponsors need to be as diligent as larger 401(k) plan sponsors because the risk is there.

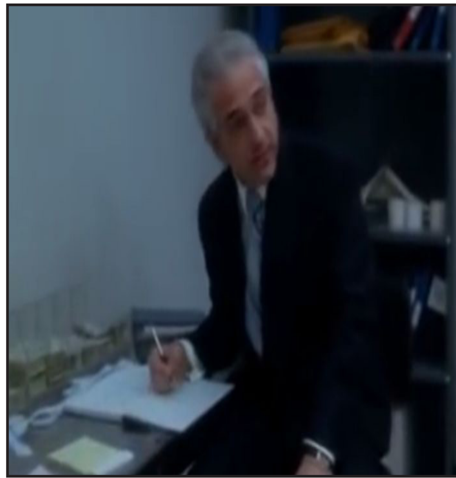
Fee Disclosure

I always love the scenes in the movie, Casino, where they reference that Nevada Gaming Commission restricted casino owners from entering the count room. It's such a nonsensical rule because it encourages theft, "skimming" by casino employees. I reference that crazy rule because we had a similar, crazy rule in 401(k) plans before the Department of Labor (DOL)

implemented fee disclosure regulations in 2012. The crazy rule was that despite the fact that 401(k) plan sponsors had a fiduciary duty to pay a reasonable fee, there was no requirement by plan providers to disclose how much fees they were generating directly and/or indirectly from plan assets. So if a third party administrator (TPA) was pocketing revenue sharing payments received from mutual fund companies and didn't let their plan sponsor clients know, it was totally legal. While most TPAs collecting revenue sharing payments used it to defray administrative expenses dollar for dollar, I know personally that there were several TPAs that would line their pockets without disclosing or fully disclosing how much they were getting. There were TPAs who would switch plan sponsors to a different platform run by the same custodian and say they were cutting their fees by 20% without telling the plan sponsor that they were getting more money in revenue sharing to offset that "cut" in fees and make more profits than by keeping the plan on the same platform. I believe fee disclosure was a necessity because if a plan sponsor has a fiduciary duty to pay reasonable plan expenses, they should know how much they're getting charged by plan providers. Many in the industry never thought fee disclosure would never be a reality because too much industry influence in Congress would foil legislation. Well the DOL realized that and implemented fee disclosure. Many complained that fee disclosure would be the end of the retirement plan business and that plan pricing for administration and financial advisory work would be a race to the bottom. 5 years later, the industry is still here and while fees have narrowed (thanks to transparency), there has been no race to the bottom.

The DOL is increasing plan audits

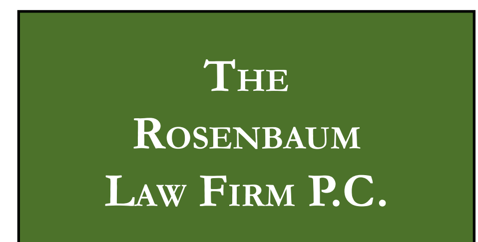
For the past 10 years, the DOL has been increasingly vigilant over 401(k) plans to make sure that plan sponsors are abiding by the rules set by ERISA in protecting plan participants. Whether it's fee disclosure or making sure that employers put in salary deferrals into a plan as quickly as possible, the DOL is making sure that the rules are enforced. When I started my practice, I said that the DOL would increase their plan audits and that was before fee disclosure was finally implemented. The reason I thought that the DOL would increase their audits is that they hired more investigators and they were implementing new



rules and practices. No government agency is going to put in new rules and practices and not increase enforcement, that's not how it works. Again, people said I was selling fear. Well, the DOL has increased their enforcement and they were asking for things that they didn't ask for 10 years ago such as plan provider contracts, investment policy statements, fiduciary meeting minutes, and plan participant education materials. A DOL audit isn't fun, it's like an invasive medical procedure because they ask for so much and many plan sponsors haven't taken their role as plan fiduciary very seriously. So again, it happened.

Revenue Sharing is becoming a bad word in the industry

When I started as an ERISA attorney working for a TPA, I was very naïve. Everything I knew about ERISA was from a course book, but that's not the reality of 401(k) plans. As I started, daily participant directed 401(k) plans were more popular because of technology and a booming stock market. I had a co-worker who told me of the increased interest in using revenue sharing paying funds because it would help defray the costs of plan administration. As it became more popular in the industry and I was less naïve, I thought revenue sharing was going to be a problem and that was right around the first litigation concerning it in 2000. As I got more involved in the sales process, the more I had issues concerning revenue sharing. To me, revenue sharing sounded like a kickback because that's essentially what is: you a plan sponsor picks a certain fund and that fund kicks a fee to the TPA because the TPA is assuming the recordkeeping cost that the mutual fund would claim they would be doing otherwise. I also compared revenue sharing to the old days of payola where radio disc jockeys would receive payments to play only certain music for which they received the payment. People thought my analogies were farcical because revenue sharing is legal and payola is not. Well, there are certain things that were legal once and were outlawed eventually. I saw how revenue sharing was marketed, where the plan sponsor was told that if they used revenue sharing paying funds, the fees for administration would decrease. So any plan sponsor who had no idea about plan expenses and how mutual fund management fees need to be part of the equation thought that the plan was paying less in fees. Index funds and lower expense active funds don't pay revenue sharing because they can't afford to. Revenue sharing is like a shell game because plan sponsors think they're getting a break on fees without realizing that they don't by picking revenue sharing paying funds that were more expensive than funds that don't. The other problem that no one in the industry saw, but that ERISA litigator did was that revenue sharing was often the primary reason why certain mutual funds were picked for specific 401(k) plans. The ERISA litigators saw what I saw: an industry where plan sponsors were encouraged to select mutual funds for their plan just because they paid revenue sharing without realizing that they may be better off by picking investments that didn't offer it. Thanks to litigation and fee disclosure, revenue sharing is being shunned because of the negative connotations associated with the practice. I assure you that the co-worker plan administrator who laughed at me when I said revenue sharing would die out isn't laughing now.



Copyright, 2017 The Rosenbaum Law Firm P.C.
All rights reserved.
Attorney Advertising. Prior results do not guarantee similar outcome.

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