What Prospective 401(k) Plan Providers Are Telling You, Is True

By Ary Rosenbaum, Esq.

If you are being courted by a 401(k) plan provider, you're probably thinking they're gaslighting you by pointing out things that may be wrong with your plan. However, most of the time, they aren't blowing smoke. Every sales pitch is designed to get you interested in that particular provider, but they may be giving you advice for a plan that is in trouble and has the potential for exposing fiduciary liability. So this article is about the truth a prospective plan provider is telling you about fiduciary liability in your role as a plan sponsor.

Costs are important

Before fee disclosure, small to medium-sized 401(k) plans would scoff at any suggestion that high administrative costs would expose them to liability. They reasoned that they were just too small to be sued by a plan participant. The problem is that being sued by a plan participant is only one exposure to liability. Thanks to their fee disclosure regulations, the Department of Labor (DOL) is serious about excessive plan administrative fees when plan participants are paying for them. As plan fiduciaries, retirement plan sponsors have a fiduciary duty only to pay reasonable plan expenses. So plan sponsors need to focus on fees and make sure that plan expenses are reasonable for the services provided. That does not mean that a plan sponsor should pick the cheapest plan providers.

Share classes are important

Fee disclosure regulations that require plan providers to disclose fees that they are paid directly or indirectly are a good thing for plan sponsors. The problem is that these plan sponsor disclosures fail to talk about mutual fund expense ra¬tios. Plan investment costs should not be discounted and can be a risk for liability if the retirement plan has more expensive share classes when less expensive retail share classes of those very same funds are available. A plan sponsor who fails to offer the cheapest mutual funds share classes available of the funds in the plan runs the risk of violating their duty of prudence. Mutual fund costs are a huge factor in affecting a participant's overall rate of return because higher expenses eat away at any investment gains. So when a plan provider analyzes investment option costs, much concern over the high costs of current investment should be shown. Keeping the eyes open on investment costs can go a long way in reducing potential liability.

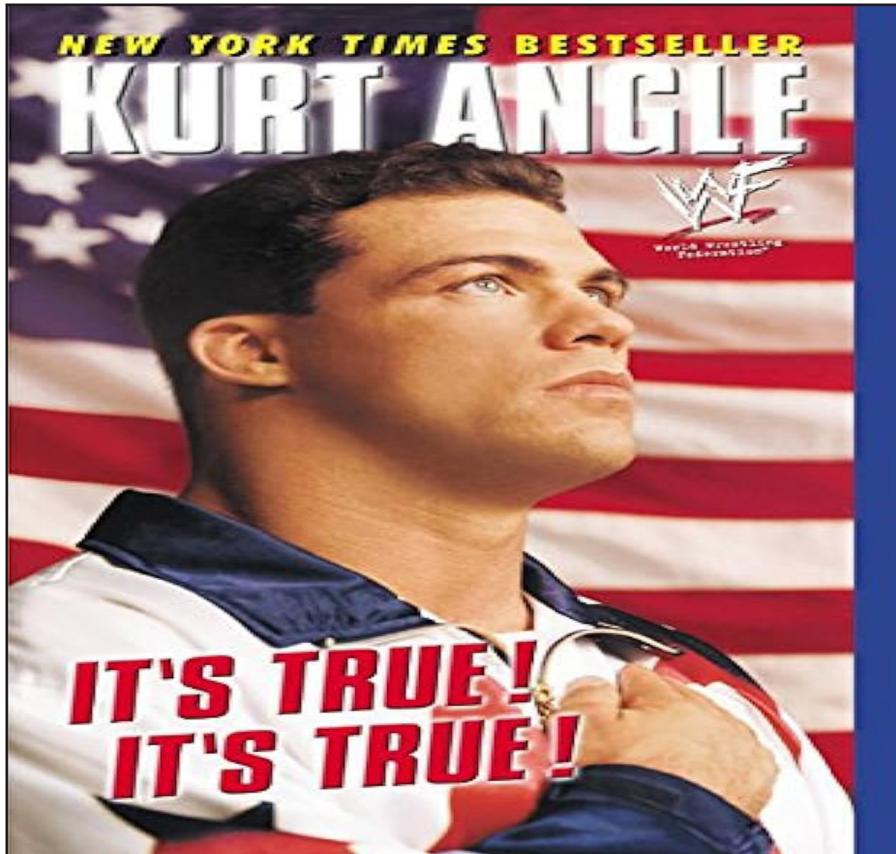
You need a financial advisor and IPS

Plan sponsors think the only role of a financial advisor is to pick investment options. While the powers that be can invest their assets on their own, they really shouldn't because their fiduciary status requires the highest duty of care. That is why the retention of a financial advisor is important. A financial advisor will not only help select investment options, they will also educate plan participants and help draft an investment policy statement (IPS). While not legally required, an IPS is an important thing to have because it will show the thinking in picking and replacing investment options in that plan. That's why it's important to follow the criteria for investments set in the IPS.

Plan design can help you save more money

A TPA just doesn't help with plan administration. A TPA also assists in plan designs that can help an employer maximize retirement savings for their highly compensated employees. That could be a safe harbor plan design, cross-tested profit sharing allocations, or maybe a design in tandem with a defined benefit or cash balance plan. Creative plan designs can leave more money in the pockets of the high-paid while making a required contribution to rank and file employees. Not every TPA can be highly effective in plan design which can cost plan sponsors by not maximizing the use of employer contributions. For example, a payroll provider TPA may do little or no plan design work that utilizes another retirement plan such as a cash balance plan. A TPA that does not have plan design

expertise can cost a plan sponsor a boatload of money and tax deductions.



A better-educated plan participant does better

Participant directed retirement plan can help a plan sponsor limit their liability under ERISA §404(c) as long as the plan sponsor provides plan participants receive enough information to make their investments. With all due respect the human resources director at my old law firm, handing out Morningstar profiles isn't enough. At a bare minimum, plan participants need to receive general investment education to help them manage their plan invest-ments. A plan sponsor may also consider offering investment advice either by their financial advisor or another provider that will give specific investment advice for a participant based on the plan's fund lineup and the participant's particular situation. Participants who receive education and/or advice have a better investment rate of return than participants who don't and plan participants who have a better rate of return are less likely to complain and/or sue.

Too many investment options depress plan participation

Too many people think that more is better and many financial advisors feel the same as they add dozens and dozens of investment options to the fund lineups of their client's 401(k) plans. I have come across retirement plans where there were 50+ mutual funds offered. The problem is that studies have shown that 401(k) plans with large investment option lineups depress employee participation in deferring their salary. Many would be surprised by that correlation, but it makes sense because too many investment options provide too much confusion to plan participants. If a plan has 5 different large-cap funds, it doesn't make plan participants feel better. If plan participants are confused, they won't bother participating in the salary deferral component of the plan. 12-15 mu¬tual funds are enough for any 401(k) plan. Anything more is overkill and only confuses plan participants, which defeats the purpose of having such a vast fund lineup.

Too many proprietary funds are not a good idea

Many mutual fund companies serve as a bundled provider where they will offer their funds on their trading platform where they will also serve as the TPA. Mutual fund companies go into the bundled provider business because it helps with the distribution of their funds and more assets under management equals more money for them. The problem is that if you go to a mutual fund company as the bundled solution, it's expected that you will use some of their proprietary funds. Why go to Fidelity, Vanguard, or T. Rowe Price if you aren't going to use some of their funds? The problem is that many plan sponsors go overkill and select most or all of the mutual funds as proprietary funds. The problem is that the decisions being selecting investment options must be sound and a court of law probably will not think that selecting mutual funds just based on the fact that they are managed by the TPA bundled provider isn't going to cut it. Too much of a good thing is s bad thing and so is using proprietary funds.

Selecting mutual funds because they pay revenue sharing isn't a good idea anymore

There once was a time when revenue sharing ruled the 401(k) landscape. Mutual funds that paid money to the TPA to pay down administrative expenses were a very popular feature back in the day because the plan sponsor had no idea what the mutual fund companies were paying the TPA and the TPA was under no obligation to tell the plan sponsor. Like bell bottoms and leisure suits, revenue sharing has fallen out of style. The reason is fee disclosure and ERISA litigation. Courts have held that if a plan sponsor used revenue sharing as the predominant reason for se-lecting funds, then they may have violated their duty of prudence. Revenue-sharing funds tend to have higher expense ratios than those that do not. So like the discussion above concerning share classes, there is more scrutiny on the expense ratios of plan investments. That is not to say that using revenue-sharing paying funds is illegal, it just means that plan sponsors have to be more diligent in investment selection.

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