

It's A 401(k) Revolution

By Ary Rosenbaum, Esq.

I'm a fan of Broadway musicals and my favorite of all time is Les Miserables. It may not be a Rodgers and Hammerstein classic, but it's always been my favorite since I saw it more than 20 years ago. I've seen it a few times on Broadway and on film. I actually had tickets for it on the night of Tuesday, September 11th. Yes, the show was cancelled that night and I haven't been back to see it since. Les Miserables is about love, family, and revolution. One of my favorite songs (out of many) is "Do You Hear the People Sing." I love the lyric "Do you hear the people sing? / Singing the song of angry men?" In the 401(k) world, we've had a revolution over the past 10 years and many people have been "singing the songs of angry men." So this article is about the "revolution" in the 401(k) world that has impacted retirement plan sponsors in how they run their 401(k) plan.

The change in technology

Before we even talk about some of the changes to 401(k) plans that occurred, one must look at how technology has really changed and impacted them over the past few years. When I was enrolled in my first 401(k) plan in 2000, the plan had a website that only showed account balances. Even though it was daily valued and provided web access through their "SmartPlan" (it was down so many times that people called it DumbPlan), any investment decisions and changes had to be done through paper enrolment changes or by the telephone. Now everything can be done pretty much

through a smartphone and when I started working in 1998, I remember a BellAtlantic sales call telling me that digital cell phones didn't catch on yet. It's just truly amazing how technology has made participating in 401(k) plans that much easier than in years past. Investment changes, deferral changes, and distribution requests can be easily made by the click of a button. Plan participants can even get investment advice online.



This technology does come out of a cost to the plan providers to set up this infrastructure, but automation does cut down costs and limits human error. I can recall how many errors were made in deferral changes and distribution requests when it was done with good old paper and an inexperienced third party administrator (TPA) employee.

The focus on fees

Whenever the stock market goes south, there's a focus on people losing money in their 401(k) accounts. When there is a focus on 401(k) account balances, reporters would always talk about 401(k) plan

fees and how they were poorly understood and not readily identifiable to plan sponsors and plan participants. Plan sponsors had no identifiable list of fees that the plan was paying and that was a problem when their fiduciary duty required them to pay only reasonable plan expenses. How can one know if fees were reasonable when their plan providers weren't required to tell plan sponsors what those fees were?

Since the period of time since 2000 included two severe stock market meltdowns, the demand that there be some type of fee disclosure to plan sponsor and participants was able to withstand political pressure to stop it. Congress through the work of Representative George Miller tried legislation to force 401(k) fee disclosure but contributions and pressure from Wall Street and the mutual fund companies stopped it. The Department of Labor (DOL) doesn't have to worry about election and fundraising, so they

implemented mandatory fee disclosure regulations after much delay and debate.

Litigation against plan sponsors intensifies

Plan participants lose money in their 401(k) accounts and they need someone to blame and ERISA litigators were happy to accommodate them by suing their employers. Much of the litigation was dealing with 401(k) plan costs since it's easier to provide damage through class action litigation. I remember the first class action lawsuit dealing with revenue sharing funds used in 401(k) plans and plan providers and

employers started winning these cases. However, time has changed court opinions on plan expenses and they have been on the side of plan participants for the past 10 years, The Supreme Court has made it easier for 401(k) plan participants to sue employers directly. Courts have even found plan sponsors to be violating a duty of prudence by using retail share classes of mutual funds when institutional (and less expensive) share classes were available from the very

same mutual funds. Courts have also ruled against employers who based most of their selection of mutual funds based on the fact that these funds pay a revenue sharing fee to TPAs to defray plan administrative expenses. Courts have far less sympathy for plan sponsor the way they did 15-25 years ago. Courts have finally grasped the idea of a plan sponsor's fiduciary duty in running their plans and the need for plan sponsors to exercise that duty prudently.

The impact of fee disclosure regulations

Many plan providers and mutual fund companies were vehemently opposed to fee disclosure regulations because they insisted that the complexity would force retirement plan sponsors to abandon plan sponsorship because of the increased diligence they needed to exert. They also insisted that fee disclosure regulations would create a "race to the bottom" where plan sponsors would only select plan providers that charged the lowest fees. Well, Chicken Little was wrong with fee disclosure regulations and the sky did not fall. Plan sponsors did not jettison their retirement plans in mass protest of the regulations and there was no race to the bottom. Administrative costs for retirement plans went down as a percentage of assets and I don't believe



that it was as a result of any race to the bottom. Much of the decrease in costs can be attributed to competition. Many plan providers such as bundled insurance companies slashed their fees because they understood that those fees were not competitive when plan sponsors would benchmark them. Technology has probably lowered plan costs, but the margins have shrunk because fees are more transparent. Plan providers who made hand over fist in fees slashed fees to remain competitive or left the business or died. The retirement plan business did not end when fee disclosure regulations were implemented, it thrived.

Investment Education/Advice Emphasized

Most of the time that I was enrolled in a 401(k) plan sponsored by the employer I worked for, there was little guidance. While there was a plan education meeting or two, most of the education that a plan sponsor would provide was the Morningstar profiles of the funds in the plan. The problem is that most plan participants aren't well educated in investments that may lead to poor investment results. The problem is that ERISA §404(c) will only limit a plan sponsor's liability in the investment losses under a participant's investment direction if plan participants have enough information to

make informed investment decisions. So if a participant can only get a Morningstar profile of funds to make investment decisions, it's likely that a plan sponsor will still be liable for the investment losses incurred by plan participants. The DOL know how important investment education and advice is, that's why they implemented investment advice regulations that allowed plan providers to finally offer it. While there are fee and auditing requirements

for providers who want to abide by it, it's proof that the government is serious that plan participants can get advice. Even plan sponsors understand that especially when they find out that there are providers like rj20.com that can offer advice if their other providers can't. The days where a plan sponsor gives little in investment education to plan participants is over.

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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