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Get Ready For The Ugly Truth About Your 401(k)

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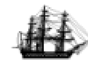

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Does your 401(k) suck? You are about to find out. Whether you are a participant in a plan, or a plan sponsor, new Department of Labor regulations require that, perhaps for the very first time, you are about to get the information that will let you determine how good or bad your retirement plan is.

What you do with that information is up to you. Be warned, many of you will probably gag.

Without any thought or planning the 401(k) has become America's pension plan. The days of guaranteed retirement income for life are long gone, and along with them the financial security that the traditional pension plan provided.

However, to date the 401(k) solution is deeply flawed. The widespread failure of 401(k)s plans to provide adequate retirement income security for American workers has caught the attention of the courts, regulators, the administration, Congress, academics and participants.

These failures include outrageous costs which bear no resemblance to value provided, deeply embedded conflicts of interest, sustained

underperformance of underlying investment vehicles, inadequate disclosure, inappropriate investment menus, defective plan design, insufficient participant education, and flawed default provisions. Cumulatively these defects do all but guarantee the failure of the participant's outcome.

While there are many excellent plans, far too many are so expensive and perform so poorly that participants are often better served to invest their retirement savings elsewhere or at least invest no more than necessary to capture matching contributions.

It isn't unusual to find 401(k) plans with total costs paid by the participant exceeding 3% of account total annually (a few outliers have plan expenses as high as 7%), with investment choices limited to subpar proprietary funds, and with payments to the various providers not related to services rendered.

Confusion about who provides what service, how much is their direct and indirect compensation, and whether or not the various parties are acting in a fiduciary capacity is the rule. The combined impact on participant accounts and retirement funding is devastating.

Despite a number of significant shortcomings 401(k) plans are the backbone of the American retirement system, and we know that families that have 401(k) plans have a great deal higher net worth than those without access. So, it's critical to improve this vital retirement funding component.

After years of study, thousands of hours of congressional testimony, hundreds of hearings, uncountable public comments, the DOL issued their final Reg 408(b)2 and 404(a) (who makes up these names, anyway?) designed to force better disclosure. With this better information it is hoped that both plan providers and participants will make better decisions, leading to improved retirement preparation for America's workers. While the

industry has been successful in delaying implementation, it appears that they will finally become effective third quarter 2012.

The Department of Labor (DOL) has recently released new rules regarding the ERISA 408(b)(2), ERISA 404(a), and electronic delivery. 408(b)(2) regulations become effective July 1, 2012, while the new 404(a) participant disclosure rules become effective August 30, 2012 with the first quarterly statements under the rules for calendar-year plans due by November 14, 2012.

The regulations expand the definition of fiduciary investment advice, and cause many consultants that are not currently fiduciaries to be considered fiduciaries. By mandating significantly higher levels of disclosure the regulations will give previously unavailable key information to decision makers.

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The flurry of enacted and proposed band aid fixes will go part of the way to improving the retirement landscape. But, regulations, legislation and the threat of court action can only go so far. The various fixes provide information and guidance to plan fiduciaries, but by themselves can't make them better fiduciaries. The plan sponsor must either develop fiduciary practices and procedures or delegate them to someone that can.

Participants make widgets or deliver services. Acting as a fiduciary and developing appropriate procedures and practices is generally outside their skill set, and a distraction from their primary interest of running a successful business. Frankly, few firms rise and fall based on the quality of their 401(k) plan.

I'm not suggesting for a moment that they don't care. Nobody wants to have a crummy retirement plan. Most employers would want for their employees to receive maximum benefits for each dollar set aside. But, wishing won't make it so. And leaving it to a product pusher that "takes care of it all" is unlikely to generate a quality plan.

The Employee Retirement Income Security Act (ERISA) requires that plan sponsors enter into only agreements with "reasonable" fees, and decisions must be made exclusively in the interest of the participant. However absent disclosure requirements, plan sponsors had no feasible ability to determine the reasonableness of their fees, or the parameters for the decision making process. In particular, the "bundled product" solution was appealing, but lacked any clarity. If the plan provider was not acting as a fiduciary, then the entire responsibility for the plan choices falls to the plan sponsor, the ultimate fiduciary.

As background, when ERISA became effective in 1974, the pension world changed dramatically, and for the better. But, reporting and record keeping became so complex that only giant institutions had or could afford the main frame computer capacity to manage the accounts. Large insurance and mutual fund companies stepped up and provided the technology and systems which enabled them to become the dominant players in the field. Remember in 1974 computer time was more valuable than gold, and the machines filled giant warehouses.

For a while the giant institutions had the field all to themselves. The pitch was simple: We will do it all, record keeping, tax returns, compliance, participant education, investments and advice. And it's free! Well, free was a pretty compelling price point, and relieving plan sponsors of all those headaches was invaluable.

Of course, it wasn't free, and the "bundled product" solution provided cover for obscene charges paid by the participants and the

perfect environment for breeding conflicts of interest. Additionally, bundled product providers seldom acknowledged fiduciary responsibility for their recommendations, leaving the entire liability for their decisions on the plan sponsors. Meanwhile the plan sponsors were led to believe that the provider was acting as a fiduciary. Disclosure ranged from opaque to nonexistent. Many plan sponsors and participants are simply stonewalled when requesting relevant information.

Long experience indicates that plan sponsors can't rely on the payroll service/insurance company/brokerage house/or fund company to overcome their deeply embedded conflicts of interest to fix their plans. Those sales entities have little interest and strong disincentives to fiduciary behavior. Most of them absolutely prohibit their agents from accepting fiduciary responsibility.
A number of unsavory practices quickly emerged:

- Restricting the investment choices to funds that shared management fees with the provider
- Use of proprietary funds where better performing, lower cost alternatives existed
- Mortality and expense charges with no economic benefit to the participants
- Special class funds with additional fees over and above retail costs
- Use of retail funds where lower cost institutional class funds were available
- Per account and per position fees assessed at each participant level
- Termination fees that effectively locked in plan sponsors from changing providers

Individually and cumulatively these fees may easily exceed "reasonable" standards, and the decisions often violate the requirement to be in the participants' sole best interest.

Today, of course, your Iphone has more

computer capacity than NASA had to put a man on the moon. So, most PC's could easily handle record keeping for hundreds of plans and the Internet provides infrastructure for seamless communications between remote providers. The stranglehold that the giant institutions had on the market is effectively broken and many excellent providers exist that can dramatically lower costs and improve every aspect of plan design.

However, without critical information, comparisons and informed decision making are impossible. The new regulations fix that.

Even the best intentioned, most diligent retirement plan sponsors and participants may have had difficulty extracting critical information from plan providers. That's about to change. The new DOL Disclosure Regulations could greatly benefit both plan sponsors and participants.

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