A THOUGHTFUL MAN’S SHORT LIST OF FREQUENTLY OVERLOOKED 401(K) FIDUCIARY DUTIES

This month’s Alert is relevant to many organizations as well as to the trustees, fiduciaries and administrators of their 401(k) plans. All companies dedicate time, attention and resources to complying with the fiduciary requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA). But in the maze of technical requirements, struggling to comply with arcane tax bulletins, legal decisions and DOL advice memorandums, one can easily lose sight of the larger picture of the Act’s intent.

For this reason, we thought that the short check list below, authored by the eminent Richard Glass of Investment Horizons, Inc., might be both thought provoking and refreshingly direct.

1. WHAT IS THE PURPOSE OF THE 401(K) PLAN?

A fundamental question to consider is whether one’s 401(k) plan is a savings or a retirement plan, or whether its purpose varies with the employee segment. The answer determines in large part the duties of loyalty, prudence and disclosure.

For most, if not all participants, the 401(k) plan functions as an offset defined benefit pension – not a savings plan – where the offsets are Social Security, a pension benefit, profit sharing and/or ESOP (Employee Stock Ownership) account. Unfortunately, countless surveys and studies have found that the average participant lacks the financial savvy to do their own retirement planning or to intelligently use software to model their retirement income needs.

Since fiduciaries are expected to incorporate current facts and circumstances into their duties, it is difficult to argue that a small portion of the fees the participants pay might not best be used to provide them with personalized gap analyses. This analysis would show each participant how much progress has been made towards achieving retirement goals. It would also provide a suggested contribution rate to help get on track.

Fiduciaries should also monitor, on the plan level, the workforce’s retirement readiness. Without this knowledge, the fiduciaries will have a hard time understanding whether or not the providers are delivering their products and services at the promised levels of effectiveness and efficiency or addressing issues that are easily masked in the absence of a retirement readiness assessment.

If, on the other hand, the 401(k) plan is described to participants as a supplemental savings program to augment their defined benefit pension, then it is much easier for the fiduciaries to justify not distributing personalized gap analyses and/or monitoring retirement readiness at the plan level.
2. IS THE PURPOSE OF THE 401(K) PLAN COMMUNICATED ACCURATELY IN LANGUAGE THAT THE AVERAGE PARTICIPANT CAN UNDERSTAND?

Do plan participants understand:

- Their roles and responsibilities in achieving their own retirement security, including adequately funding their 401(k) account and periodically monitoring their progress?
- That the 401(k) plan is really a tax-advantaged tool to help them achieve retirement security and not a traditional pension plan with mandatory employer contributions?
- The limitations of professional investment management and the fragility of the underlying assumptions?
- That assumptions that seem reasonable today may not be acceptable in the future due to changing economic conditions?

Unless participants understand these realities, the fiduciaries and sponsors are potentially setting the stage for unwanted 401(k) litigation and a demoralized and less productive workforce that will not be able to retire. Thus, the communications and tools the participants receive must:

- Support the 401(k) plan's purpose.
- Reflect the participants' educational capabilities and limitations, especially regarding financial literacy and math skills.
- Be designed to manage participant expectations. If they aren’t, unrealized expectations will likely create a backlash – unwanted litigation – against the sponsor and fiduciaries.

3. HOW DO FIDUCIARIES MONITOR WHETHER OR NOT THEIR DECISIONS AND THEIR VENDORS’ PRODUCTS AND SERVICES ARE HELPING PARTICIPANTS ACHIEVE RETIREMENT SECURITY?

Traditional benchmarks that supposedly measure the fiduciaries' judgments as well as the value participants receive for the fees they pay compare:

- A plan's fees and the services with those of plans of comparable size.
- How a plan's participants behave, such as contribution and participation rates, with those of other plans of comparable size as well as their recordkeeper's overall book of business.

Unfortunately, the traditional benchmarks don't report, let alone monitor, changes in the participants' retirement readiness. Without knowing this metric, it is difficult, if not impossible, for the fiduciaries to:

- Ascertain whether or not their decisions and their vendors' products and services are having the desired effects.
- Determine what specifically is or is not working.
- Arrive at possible alternative approaches to address the issues.

The traditional approach to benchmarking, then, does little to help fiduciaries prudently manage their 401(k) plan. It also sets the stage for a workforce that won't be able to afford retiring at their normal retirement age, if at all. Such a result increases the chances of unwanted litigation and will be a severe drag on corporate profitability.
4. HAVE THE FIDUCIARIES IDENTIFIED POTENTIAL CONFLICTS OF INTEREST, AND ARE THEY MONITORING THEM TO MAKE SURE THEY DON’T MATERIALIZE?

Potential conflicts include:

- What fiduciaries should be doing to fulfill their duties to participants sometimes conflicts with what they feel comfortable doing as employees of the sponsor.

- Sponsors want their employees to appreciate their 401(k) plans. They are worried that if large numbers of employees knew their contribution rates should be greater than 15% or 20%, their employees would be up in arms given the current high level of corporate earnings and executive bonuses. However, when asked what would get them to save more, the SSgA DC Investor Survey 2013 found that 74% of the respondents wanted “clear examples (showing) how what I save today will pay off in the future.” These “clear examples,” of course, are well designed gap analyses that relatively few plans distribute.

- Target-date funds (TDFs) are the most popular QDIA (Qualified Default Investment Alternative): Congress endorsed these professionally managed investment options because it felt that the average participant did not know how to manage their account. However, as the GAO pointed out, TDFs won’t help participants achieve retirement security unless the participants can use them wisely, which requires understanding the TDFs’ assumptions (which are seldom, if ever, disclosed) so that participants can adjust their contribution rates for the size of their account balances and their time horizon.

Periodically giving participants well designed, personalized gap analyses would address these issues. Recordkeepers, however, seldom offer these gap analyses as part of their services.

In conclusion, fiduciaries have a duty to monitor both their decisions and whether or not their participants are using the 401(k) plan wisely, including the use of and success with TDFs and managed accounts. This exercise can be accomplished by monitoring changes in the participants’ retirement readiness.
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1 Also of possible interest to those in similar positions at 403(b) plans of not-for-profit organizations and educational institutions.

2 Richard D. Glass, PhD, CEBS, is president of Investment Horizons, Inc., and his firm has pioneered the use of Retirement Readiness Assessments to help make 401(k) fiduciaries more cognizant of the magnitude and scope of their fiduciary responsibilities and potential liability exposures. Richard is a prolific writer and frequently conducts educational sessions for fiduciaries. His email address is rglass@investmenthorizons.com.

3 SSgA DC Investor Survey 2013, http://www.google.com