ADVISOR INSIGHTS

The Retirement Plan Industry's Troubling Framework

Fiduciary buyers bear virtually all the legal responsibility, but it's the nonfiduciary sellers that largely control them, argues contributor Scott Simon.

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"You mean I won't get on-site access?"

My questioner and I were attending a meeting with a plan sponsor's working group. We were planning how the new recordkeeper--an insurance company that employed the questioner--and my Registered Investment Advisory firm were going to take control from the previous bundled recordkeeper.

The 401(k) plan had approximately 2,000 participants, and my RIA firm had been retained as a (nonconflicted) investment manager pursuant to section 3(38) of the Employee Retirement Income Security Act of 1974, or ERISA, to be solely responsible (and liable) for selecting, monitoring, and (if necessary) replacing the plan's investment options. The plan hadn't previously retained a 3(38), but the request for proposal it issued had called for one this time. Apart from my RIA, the new recordkeeper was also a bundled recordkeeper.

After I replied to my questioner "No, you won't have on-site access," he slammed shut his iPad upon which he had been scribbling notes feverishly for the entire two-hour meeting.

He was furious for two reasons. First, his employer--the new insurance company recordkeeper--wouldn't be able to influence participants as to which plan investment options they should invest in. The previous insurance company

recordkeeper maintained, essentially, an on-site sales office, which is why 45% of the plan's assets were invested in the recordkeeper's proprietary stable-value fund. That earned the record-keeper a cool few million dollars each year. My questioner, no doubt, was licking his (financial) chops over that possibility. In addition to its hidden (and therefore high) costs, a stable-value fund in my view is hard to exit in times of market stress (such as at present), which can be costly and dangerous to plan participants, especially older ones.

The second reason why my questioner was furious was that his team of licensed salespeople wouldn't be permitted to sell nonplan, retail financial products and services to plan participants, including annuities, life insurance, individual retirement accounts, and 529 accounts. They wouldn't be able--under the guise of providing "enrollment," "education," "information," or other such services--to sit down and meet with plan participants to establish personal "relationships" in order to sell them retail products and services.

This inability to sell at both the plan and retail level reduced the expected financial bounty that the new insurance company recordkeeper had expected to reap.

Although it's not very politic to say, I don't think my questioner and his team cared a whit about educating, informing, or helping plan participants in any way. If an insurance company (or other kind of recordkeeper, for that matter) and their employees happen to educate, inform, or help participants, that's fine and wonderful, but it's merely a byproduct of the sole reason for the existence of an insurance company (or other like entity), which is to sell, sell, sell.

That doesn't make insurance companies (or any other plan provider, for that matter) bad--after all, that's capitalism. It's just the nature of the business model and regulatory framework that governs the retirement plan industry in which they operate. That's how the people like my questioner made a living. It also helped to explain why, when my RIA came on board, I found that 45% of the plan's assets were held in the previous insurance company recordkeeper's stable-value fund.

While a recordkeeper's business model is good for the recordkeeper's company, the model is often destructive to plan participants. For it reflects the fact that the retirement plan industry is--and always has been--a bifurcated one. That is, ERISA demands a fiduciary-rich environment in which plan participants (and their beneficiaries) are the sole and exclusive focus. But most plan providers operate according to the "morals of the marketplace," whereby plan sponsors must operate in a *caveat emptor* environment in which fiduciary buyers--sponsors with fiduciary responsibilities on behalf of plan participants--should be wary of nonfiduciary sellers (insurance companies, and others) that are out to maximize revenues at their expense.

In the retirement plan industry, then, fiduciary buyers bear virtually all the legal responsibility (and liability), but it's the nonfiduciary sellers (with little real liability) that largely control them. The real problem is that few fiduciary buyers have any understanding of the nature of this bifurcation. They are usually led around by salespeople with nary a fiduciary duty in sight. Indeed, what has been mind-boggling--at least to me--over the past decade or so when 401(k)s and other plans have been sued on a widespread basis is that even many "jumbo" 401(k) plans with billions of dollars in assets are operated by those with no more skill (and often less) than those exhibited by sponsors of mom-and-pop plans.

This particular tale, though, has a happy ending. My RIA--having sole responsibility for the plan's investment menu--was able to save participants in the 401(k) plan a large multiple of my fees over nearly the next decade.

The key takeaways:

- An RIA with discretion over a plan's investment menu has a lot of power to help plan participants (and their beneficiaries) enhance their retirement income security by offering low-cost and diversified investment options.
- Such an advisor--as long as a plan sponsor is agreeable, and it's likely that it would be if it's smart enough to retain a 3(38) investment manager--can also help protect plan participants from salespeople intent on selling them nonplan, retail financial products and services.
- Such salespeople should be forbidden from accessing plan participants within the ERISA environment.

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