

---

## The Fine Madness of the 401(k) Business

---

By Kerry Pechter     *Fri, Mar 27, 2015*

---

*Most of the workshops and discussions at the NAPA Summit in San Diego were devoted not to the pending DoL fiduciary proposal but to potential solutions to the problems that retirement plan advisors grapple with every working day.*

---

The only cloud over the NAPA Summit this week—San Diego’s bluebird sky was unblemished—was uncertainty over the havoc the Department of Labor’s still undisclosed “fiduciary rule” might wreak on the 401(k) industry and the way it handles rollover IRAs.

In his welcoming address on Sunday, American Retirement Association (ARA) Brian Graff noted that Labor Secretary Tom Perez’s recent political blitz on Capitol Hill, backed by the President’s own harsh characterization of the industry, is unprecedented.

Mr. Perez “has had over 50 meetings with Senators on this issue” said Graff, whose job is to lobby the same Senators in the other direction. “No sitting Secretary of Labor has ever done that. [The administration] is painting the assumption that we’re all bad.”

The headline message was dire, to be sure. But, judging by the 1,000+ attendees and hundreds of vendor booths at the conference (the first since the National Association of Plan Advisors and the American Society of Pension Professionals and Actuaries merged under the umbrella of the ARA), the 401(k) industry is thriving. This is a multi-trillion-dollar business, after all, to which tens of millions of Americans send money every payday.

A few interviews with conference attendees—mostly advisors who sell and service retirement plans—showed a wide range of sentiment about the President’s accusation that certain plan advisors are “bilking hard-working Americans” by steering their IRA rollovers out of 401(k) and into investments that cost far more than 401(k) investments do.

One insurance company employee, manning one of the booths, told *RIJ* with dismay that “it seems like the government just wants to take over this whole business.” But others conceded that a problem does exist. Over coffee, muffins and yogurt parfaits on Monday morning, an industry veteran and conference speaker acknowledged that the government’s concerns were not groundless.

Speaking privately, he told *RIJ* that “more than a few” registered reps, insurance agents and in particular advisors from the big banks or “wirehouses” enter the 401(k) business mainly to capture assets when participants, especially large-balance participants, leave their plans

and roll their tax-deferred money into individual IRAs, where profit margins are potentially much greater.

### **Vague rules**

Most of the workshops and discussions in San Diego were devoted however not to the still-secret DoL proposal (which the Office of Management and Budget is now reviewing, and which may or may not be as aggressive as some hope and others fear) but to potential solutions to the problems that plan advisors grapple with every working day.

For instance, a perennial challenge for many of them is to stay compliant with the regulations that govern retirement plans, which are often vague. For instance, the rules offer little specific guidance on how to divide the costs of administering a plan among the plan participants, only that the method be prudent and reasonable.

Questions abound. Should the employer pay the ongoing costs of the plan, or should the participants pay individually? Should each participant pay the same fee for plan administration, or should the payment vary with the size of the account balance? If the employer pays, can he be reimbursed by the plan recordkeeper out of the money—revenue-sharing—that it receives from the investment companies, who pay it out of what the participants pay its funds? The regulations don't say.

Here's an example of how easy it is to go wrong. During the Q&A after a presentation by ERISA attorney Fred Reish and fiduciary consultant Philip Chao, an advisor asked ingenuously if it was OK for all of the plan fees to come out of the fees paid on investments in the guaranteed investment certificate (GIC). The GIC was so profitable for the investment company that it could afford to share its fees with the plan. No, said Reish. Such a method would shift all of the costs onto the GIC investors and give other participants a free ride.

But the vagueness of the regulations also gives plan advisors room for creativity, and competitive pressures can inspire advisors to test the limits of the regs to please the plan sponsors who hire them. One speaker, for instance, showed advisors how they can differentiate themselves and win more business in the small plan market by knowing how to design plans that maximize a company owner's tax benefits and minimize his costs.

Attorney Ken Marblestone, of the Philadelphia-based MandMarblestone Group, demonstrated a technique by which a hypothetical small business owner could steer 85% of his plan contributions to four highly-compensated employees—himself, his wife, his son and his father—and only 15% to ten lower-level employees, while still meeting the Labor

Department's fairness requirements.

[In an interview, Marblestone told *RIJ* that, while the small business owner as plan sponsor is a fiduciary to the plan, the process of designing and setting up a plan is not a fiduciary function. Therefore, the owner can design a plan that favors his own interests as much as possible without violating his or her fiduciary obligations under ERISA.]

### **The rollover conundrum**

A critical area for advisors revolves around the issue of advice, and its relation to rollovers. The ARA, which lobbies for NAPA members, worries that the DoL's forthcoming proposal—whose specifics are still unknown—might stop or discourage plan advisors from serving as (and reaping the benefits of being) individual advisors to participants who leave the plan.

The ARA has even started a lobbying campaign, complete with humorous online video that satirizes government bureaucrats, urging legislators to “Stop the No Advice Rule” and arguing that it's nonsensical to prevent people from continuing with the same advisor on their IRA that they had on their 401(k) account.

The DoL, however, believes that advisors who give investment advice directly to plan participants too often abuse their privileged, trusted position by encouraging participants to roll their 401(k) balances (upon retirement or separation) into retail IRA accounts where they will most likely pay higher prices for products and services than if they just left their money in the plan.

But, as noted above, it's an open secret that some plan advisors (or the firms they work for) are pure asset-gatherers who enter the low-margin retirement plan business specifically to capture big-ticket rollovers, either for themselves or the firms they work for. One executive for Morgan Stanley's wealth management business, a conference panelist, said that his company, which provides financial education to plan participants, is interested in identifying opportunities for rollovers of a million dollars or more. It provides education, he said, so that people will think of Morgan Stanley first when they retire or change jobs.

The DoL has said that it would prefer that 401(k) participants keep their money in their plans until they retire and need income. But that's as impractical as expecting children to live with their parents (and stay chaste) until they get married. Rollovers are all but inevitable. People can't always get the products or services they need inside their 401(k) plans. And it's difficult to provide products or services at the individual retail level as

cheaply as providing them at the group or wholesale level. In some cases, ironically, the funds in a 401(k) plan might even be more expensive than the funds available in a rollover IRA.

Meanwhile, serious flaws in the 401(k) system remain unaddressed. For instance, even if people wanted to stay in their 401(k) plans indefinitely, about half of 401(k) plans don't offer retired participants the option of taking systematic withdrawals. As one advisor pointed out to *RIJ* during a refreshment break on the trade show floor, many plan administrators still arbitrarily charge the same price for making a recurring electronic transfer from the plan to a retiree's bank account that they charge for issuing of a one-off distribution check to a terminated employee. That tends to make the price of offering systematic withdrawals prohibitive to the sponsor, but lucrative for the provider.

© 2015 RIJ Publishing LLC. All rights reserved.