



OPPORTUNITY KNOCKS IN 401(K) PLAN DEVELOPMENTS

AS CO-FIDUCIARIES, INDEPENDENT RIAs CAN PROVIDE RETIREMENT PLAN SPONSORS WITH ADVICE ON INVESTMENT SELECTION AND HELP STRIP AWAY THE CONFLICTS OF INTEREST THAT ARISE IN TARGET-DATE FUNDS AND OTHER 401(K) PLAN FEATURES.

Change is taking place in the defined contribution plan industry, and plan participants stand to benefit.

The Pension Protection Act of 2006, which has moved the industry closer to participant-focused 401(k) plans, was written with the goal of engaging more employees in their plans and improving on the quality of investments. Real success has been seen since the PPA was enacted.

For example, the Government Accountability Office reported in October that the percentage of plans with automatic enrollment policies increased from about 1% in 2004 to more than 16% in 2009. In fact, the GAO found, participation rates can reach as high as 95% under automatic enrollment. This is one of the PPA's brightest achievements.

The PPA also aimed to enhance investment selection and management. Enter the rise of target-date funds, the qualified default investment alternative of choice over the last several years. The GAO found 87% of Vanguard's defined contribution group plans with automatic enrollment relied on target-date funds as their default investment through December 2008, compared with only 42% in 2005.

Concerns dog target-date funds

Target-date funds were touted as turnkey diversification and management solutions tailored to the investor's retirement time horizon. But as always, the devil is in the details.

The truth is that many target-date funds are overpriced and have underdelivered.

The range of performance from supposedly comparable target-date funds during the market downturn has brought scrutiny to both the funds themselves and the target-date strategy altogether.

According to DALBAR, Inc., a financial-services market research firm, target-date funds showed strong bias to equities when compared with industry norms.

A report released by the Senate Committee on Aging following its Oct. 28 hearing on target-date funds cites that there may be "an embedded conflict of interest when mutual funds include their own proprietary funds in their target-date funds, noting concerns of self-dealing." Target-date funds generally have a multiple-tier fee

structure - that is, expenses for both the parent fund as well as each of the component funds.

Certainly the concept of a target-date solution has the potential to improve investment options for plan participants. Yet, recent developments concerning target-date funds exemplify the problems facing 401(k) plans at the expense of both employers and employees. Concerns about conflicts of interest, self dealing and lack of education are hampering the success of target-date funds, especially among middle-market businesses.

The 401(k) Fair Disclosure for Retirement Security Act of 2009, a bill proposed by Rep. George Miller (D-Calif.), contains a notable provision requiring plan administrators to provide records that:

1. specify the plan services to be provided;
2. provide the expected total annual service charges allocated among specified components; and
3. disclose the impact of different mutual fund investment share classes, as well as financial relationships with service providers and any free or discounted services provided by them.

Fund lineups are often constructed with the plan provider's revenue target as the foremost consideration. This is accomplished by offering proprietary mutual funds as well as non-proprietary funds under revenue sharing arrangements. As a result, participants pay unnecessarily high fees for fund offerings.

As things stand now, the plan provider's interests are clearly not aligned with the best interests of plan participants. If passed, Miller's bill would increase plan transparency and serve as a real victory for plan participants.

This is just the tip of the iceberg. Plan sponsors are beginning to seek objective outside advice in a shift that highlights their understanding of what it means to have a fiduciary responsibility to plan participants.

Independent registered investment advisers (RIAs) have a reputation for bucking the conflicts of interest inherent in the financial advisory industry. RIAs function as fiduciaries to their clients and therefore have a legal obligation to act in their best interest.

As co-fiduciaries to retirement plan sponsors, independent RIAs provide advice on investment selection and help strip away the conflicts of interest that arise in 401(k) plans. Plan sponsors have access to a resource that can help them design and implement an objective, transparent and low-cost plan that improves employee participation and investment performance.

An independent RIA acting in a co-fiduciary capacity can also serve as an ally to employees and help provide plan education to address investment selection, the importance of enrollment and increasing contributions.

This trend is positioned to accelerate as leaders in government recognize the need to bring independent, conflict-free advice to the 401(k) market.

In fact, Rep. Rob Andrews (D-N.J.), author of The Conflicted Investment Advice Prohibition Act of 2009, seeks to allow plan participants "to receive investment

advice from an independent investment adviser that is registered under the Investment Advisers Act of 1940 and meets certain other qualifying requirements, including that the adviser (and any affiliate) does not provide or manage any investments in which the plan assets of any individual account plan are invested."

In short, the bill encapsulates a belief that the advice of an objective fiduciary is important enough to 401(k) plan participants that it should become law. Perhaps Andrews was taking a cue from the shift taking place in the retail investment management market.

A recent report by Aite Group, an independent financial services industry research and advisory firm, found that wirehouse brokers lost 2.1% of their market share between the end of 2007 and the end of 2008, while independent RIAs gained 1.1% of the market.

It is little wonder that during a period of great market volatility and uncertainty, clients have gravitated to the investment adviser, who is required to place the client's interests ahead of his or her own. Surely plan participants should be afforded a comparable opportunity.

Progress has been made within the defined contribution market since enactment of the PPA in 2006. But the need for conflict-free and objective advice is still sorely needed since a true participant advocate has yet to be introduced to the defined contribution plan equation. Doing so will not only increase employee satisfaction but will also lead to greater success in retirement planning.

By John Burns
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