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The Different Flavors of ERISA Fiduciaries, Redux (Part 5)

by W. Scott Simon | 07-01-10

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Much of the industry that provides services to qualified retirement plans such as 401(k) plans that are governed by the Employee Retirement Income Security Act of 1974 is, in a word, goofy.

This industry--with relatively few exceptions--is composed of plan investment service providers with nary a fiduciary bone in their bodies. These non-fiduciaries have no meaningful obligation to disclose the total costs that they bring to the table when proposing bundled or unbundled investment and administrative services to plan sponsors.

The Yawning Disconnect

This state of affairs creates a yawning disconnect: Providers have no duty to disclose costs to plan sponsors, while sponsors have the fiduciary duty under ERISA to know what those costs are. Indeed, the very heart of ERISA--section 404(a), with its great sole interest and exclusive purpose rules which are expressions of the ancient duty of loyalty underlying all fiduciary law--requires that plan sponsors, when selecting and monitoring service providers, not only to know what costs are being charged to their plans but also to know what services the plans receive in exchange for those costs.

This is a system in which non-fiduciary service providers have a monopoly on most of the important information about retirement plans; this means that many providers essentially lead plan sponsors around by the nose. We would expect this asymmetric information flow to be particularly effective against the interests of participants (and their beneficiaries) in plans sponsored by mom-and-pop firms. Many of these firms don't know any better simply because they don't have the staff to go up against the superior knowledge of such providers. All too often, this results in non-fiduciary service providers bamboozling fiduciary plan sponsors into signing off on goofy plan investment options loaded with hidden (and therefore high) costs and high risk.

Exhibit A: Wal-Mart

No one would expect, however, that the asymmetrical information flow used by many plan service providers to gain advantage over plan sponsors would be effective against, say, companies in the Fortune 500. And yet we have Exhibit A--Wal-Mart--to negate this entirely reasonable supposition. For those of you who don't know, Wal-Mart was sued by one Jeremy Braden because he believed that Wal-Mart breached its fiduciary duties owed to the participants (and their beneficiaries) in the Wal-Mart 401(k) plan. This plan (purportedly the largest in America participant-wise, with over 1 million of 'em; and \$10 billion to \$12 billion in plan assets) offered 10 investment options--three of which were a stable value fund, a money market fund, and Wal-Mart stock.

That left seven mutual fund options, all of which were actively managed. Braden alleged that these funds were priced at retail cost--and high retail cost to boot. And why would that be? Because Braden alleged that such pricing was present to compensate the custodian and trustee of the plan assets. Braden alleged in his lawsuit that such revenue-sharing payments made to the custodian were not paid for services rendered but instead were "pay to play" payments made by the providers of the mutual fund investment options (mutual fund companies) to the custodian in exchange for the custodian "advising" Wal-Mart to include such options in Wal-Mart's 401(k) plan. Retail-priced mutual funds being what they (often) are, Braden also alleged that the seven funds charged 12b-1 fees as well.

The Verdict: Goofiness All Around

The U.S. district court threw out Braden's case, but the U.S. Eighth Circuit Court of Appeals reinstated it at the end of last year. Even should Wal-Mart eventually prevail on all, can anyone in their right mind believe that more than 1 million participants in the Wal-Mart 401(k) plan have been well served? There is absolutely no justification whatsoever for the participants in the Wal-Mart 401(k) plan (or any size plan for that matter) to have to invest in retail-priced investment options. If Wal-Mart, with all its resources, cannot get such a basic concept right, then certainly there's a huge amount of room in the retirement plan industry for professional fiduciaries that can.

May we have the verdict on the Wal-Mart 401(k) plan (and other plans similarly situated), please? Count one--retail-priced mutual funds instead of institutionally-priced funds; verdict: Goofy. Count two--revenue sharing payments made to anyone but especially to a custodian/trustee/fiduciary instead of no such payments made at all; verdict: Totally Goofy. Count three--12b-1 fees paid to fund families instead of no such payments made at all; verdict: Way Goofy.

The Solution

Much of the industry that provides services to qualified retirement plans such as 401(k) plans, as noted, is composed of non-fiduciaries who largely control the flow of information to fiduciaries. Given this current state of affairs, there's very little off-loading of fiduciary responsibility and liability from the shoulders of plan sponsors onto those of professional fiduciaries.

Despite this, since its inception in 1974, ERISA has provided ways by which plan sponsors can offload their fiduciary responsibilities and liabilities. For example, a plan sponsor can delegate its duties to select, monitor and replace plan investment options to an ERISA section 3(38) Investment Manager (while retaining the duty to ensure that such delegation is prudent and remains so on a periodic basis). Any plan sponsor that wishes to offload virtually all its fiduciary responsibilities and liabilities can do so (again, subject to its monitoring duty) by delegation to a professional ERISA section 402(a)(3)(21) Named Fiduciary.

Many in the industry, of course, are adamant that plan sponsors always possess full responsibility and liability for anything that goes on in their retirement plan which is why they doubt the validity of delegation of same to others. On the other hand, there are those such as yours truly who think it quite clear that ERISA allows delegation of discretion, and therefore fiduciary responsibility, and hence fiduciary liability. Reasonable folks may respectfully disagree about this issue.

There can be no such disagreement, however, about a multiple employer plan. The sponsor of a qualified retirement plan such as a 401(k) plan that wishes to offload all its fiduciary responsibilities and liabilities can do so by placing its plan in a MEP. All fiduciary responsibility and liability then rests with the sponsor of the MEP. MEPs are unique in that if a MEP sponsor is independent of all the plan sponsor employers that join the MEP, the employers legally have no fiduciary responsibility or liability. Employers yield all fiduciary responsibility to the MEP sponsor by joining a plan with an existing fiduciary infrastructure. All fiduciary responsibility and liability is therefore borne by the sponsor of the MEP. The MEP sponsor is primarily responsible for managing all plan service providers and ensuring that the MEP operates according to all ERISA/IRS/DOL requirements and the MEP plan document. No plan sponsor employer that decides to join a MEP has any responsibility other than to make sure that its participant employees get enrolled, and that their contributions to the MEP are made on time. Both such functions are merely ministerial, not fiduciary, in nature.

So the industry argument and the argument advanced by independent fiduciaries are, in a way, both correct. Responsibility and liability does indeed rest with the plan sponsor. The sponsor of a MEP, however, is an independent fiduciary. When plan sponsor employers join a MEP, they join a plan where they possess no discretion or authority over its management and operation. Boy, those ERISA drafters sure were wise birds.

By the way, after writing about MEPs in this column last August

[<http://www.morningstaradvisor.com/articles/article.asp?s=0&docId=16955>], I heard from some readers who questioned the validity of a MEP. I simply noted that, according to BrightScope, nearly 4,000 MEPs are in existence today across America--some with billions of dollars in them--and told such Doubting Thomases to call up those running these MEPs and ask them how valid they are. Indeed, the

Thrift Savings Plan sponsored by the federal government is an MEP of sorts. Now if only Wal-Mart would place its 401(k) plan in a MEP, hmmm.

Getting it Right for Plan Participants and Plan Sponsors

The ultimate protection for the sponsor of a qualified plan under ERISA such as a 401(k) plan lies in the sponsor protecting plan participants (and their beneficiaries). The best way, in my mind, to ensure this protection is to have professional fiduciaries running qualified retirement plans (as ERISA intended from the beginning)--not non-fiduciary plan service providers leading amateur fiduciary plan sponsors around in the dark. Making sure that the great sole interest and exclusive purpose rules of ERISA section 404(a) are adhered to prudently gives plan sponsors all the protection they need. As I've said before in this column, getting it right for participants (and their beneficiaries) gets it right for plan sponsors, and vice versa. Any qualified retirement plan under ERISA, to the fullest extent possible, should be served by loyal, prudent, professional independent fiduciaries that know how to act with knowledge and skill, and are willing to be legally accountable for their decisions.

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W. Scott Simon is an expert on the Uniform Prudent Investor Act and the Restatement 3rd of Trusts (Prudent Investor Rule). He is the author of two books, one of which, *The Prudent Investor Act: A Guide to Understanding* is the definitive work on modern prudent fiduciary investing.

Simon provides services as a consultant and expert witness on fiduciary issues in litigation and arbitrations. He is a member of the State Bar of California, a Certified Financial Planner, and an Accredited Investment Fiduciary Analyst. Simon's certification as an AIFA qualifies him to conduct independent fiduciary reviews for those concerned about their responsibilities investing the assets of endowments and foundations, ERISA retirement plans, private family trusts, public employee retirement plans as well as high net worth individuals.

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Reader Comments (2)

July 2, 2010 11:02 pm

Scott --

Good, thoughtful article as usual. I am always delighted to read your work. However, I take issue with your use of the term goofy. That wording makes it seem that the ideas are silly, perhaps erroneous, but not all that serious. I continue to believe that deliberately obfuscating expenses is unethical, VERY serious, and deeply damaging to people who falsely believe they are doing the right thing by saving diligently.

In the end, the only way to protect oneself seems to be to change jobs every few years and take the opportunity to roll the 401(k) or 403(b) into an IRA in a no-load family where a person can know and manage expenses.

Thank you for your thinking on these issues. JuJu

- JuJu, ME

July 2, 2010 03:57 pm

This is a very well written piece on the benefits of a multiple-employer plan.

Our independent third party administration firm continues to actively market these programs to Professional Employer Organizations (PEO's) and Associations through advisors across the country.

Apart from the significant benefits gained by reducing the liability for the adopting employer, existing single employer plans that may be currently subjected to an annual audit from a CPA as part of their Form 5500 submission typically see a complete elimination of that out-of-pocket cost (the MEP itself is

subject to an audit, not each of the adopting employers).

Plan document/restatement fees are also typically eliminated or greatly reduced as well for the adopters.

As employers (and their advisors) look for ways to lower plan expenses and lessen the legal burden on the plan trustees, these programs will continue to gain popularity in untapped markets across the country.

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