



# Fulfilling the 401(k) Promise

Why independent advisors are in the best position to fulfill the promise of the 401(k) plan for America's workers.

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The Advisor Lab, LLC | [www.theadvisorlab.com](http://www.theadvisorlab.com)

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## History

- The closing of the Studebaker automobile plant in South Bend, Indiana, is generally regarded as the pivotal event in the movement towards comprehensive federal regulation governing private pension plans culminating in the passage of ERISA.
  - The Studebaker pension plan was so poorly funded that 4,000 employees with an average age of 52 and average service of over 22 years received just 15% of their vested pension benefits.
- Thus, ERISA wasn't established to mandate retirement plans or retirement benefits; it was created to regulate the operation of established retirement plans to ensure that, unlike in the case of Studebaker, *employees receive their promised benefits*.

Fiduciaries  
have a duty  
to minimize  
plan expenses.

## Fiduciary Mandate

- In crafting ERISA, Congress looked to the traditional or common law of trusts – simply put, trusts are arrangements where property is managed by one person (or persons, or organizations) for the benefit of another.
- ERISA requires that all plan assets (except insurance contracts) be held in trust and, as under trust law, those responsible for investing and managing retirement plans must live up to high fiduciary standards including:
  - **Duty of Loyalty (Exclusive Purpose Rule)** – a duty to act solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits *and minimizing expenses*;
  - **Duty to Act Prudently (Prudent Expert Standard)** – a duty to act with the care, skill, prudence and diligence under the circumstances then prevailing that a *prudent man acting in a like capacity and familiar with such matters* would use the conduct of an enterprise of a like charter and with like aims;
  - **Duty of Diversification** – a duty to diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and
  - **Duty to Follow Plan Documents** – a duty to act in accordance with the documents and instruments governing the plan insofar as such documents and instruments are not inconsistent with the provisions of ERISA including the plan’s investment management agreements and investment policy statement.

Fiduciaries'  
personal wealth  
is at risk.

## Liability for Breach of Fiduciary Duties

- ERISA Section 409(a) imposes personal liability on fiduciaries that breach their fiduciary duties. In other words, plan fiduciaries put their personal net worth at risk, if their conduct is deemed imprudent.
- “Fiduciaries of an employee benefit plan [such as a 401(k) plan] are charged with carrying out their duties prudently and solely in the interests of the participants and beneficiaries of the plan, and are subject to personal liability to, among other things, make good any losses to the plan resulting from a breach of their fiduciary responsibilities” ERISA Interpretive Bulletin 96-1
  - *In the Enron settlement outside members of the Board of Directors and the chair of the plan committee contributed to a settlement from their personal assets.*

## The Shift in Retirement Savings Obligations

- In the 35 years since the passage of ERISA there has been a dramatic migration from traditional pension plans to 401(k) plans and the pace of that transition is only accelerating
- This move to defined contribution plans has resulted in both a ***shift of investment risk*** to plan participants, but also a transition of the following retirement savings obligations:
  - Management of investments – the vast majority of 401(k) plans are participant-directed
  - Retirement funding – the 401(k) plan was created to facilitate and encourage retirement savings by employees
    - in the case of matching contributions, employer funding is wholly dependent on employee contributions
  - Payment of plan expenses – fees paid from the trust now directly reduce a participant's nest egg rather than increase an employer's funding obligation

## The shift in retirement savings obligations to participants has not resulted in a change in legal responsibility...

- Even in a participant-directed plan, it remains the plan's fiduciaries and not the participants that have the ultimate legal responsibility for investing plan accounts.
- Indeed, courts have held that plan fiduciaries receive the protection offered by ERISA 404(c) only where the investment options offered to participants are suitable and prudent for the plan and remain so on an ongoing basis.
- Therefore, in a participant-directed 401(k) plan, the critical and inescapable issue for the plan fiduciaries is fundamentally the same as in a traditional defined benefit plan, the appropriate selection and monitoring of the investment alternatives (or, in the case of a 401(k) plan, the menu offered for participant-direction).

## Indeed, shifting the burden to participants may magnify certain fiduciary obligations

- The payment of plan fees from participant accounts has resulted in a heightened level of scrutiny from both
  - Regulators
    - **2004 – ERISA Advisory Council Report** concludes that the shift to asset-based fees makes it difficult for plan sponsors to understand fees paid.
    - **2005 - SEC Report** based on industry-wide investigation of mutual fund practices raises concerns about disclosure of potential conflicts of interest.
    - **2006 – GAO Report** states 401(k) participants may be losing thousands of dollars in retirement savings because of fees charged.
  - And plaintiff's attorneys -- a series of class action lawsuits have been filed challenging service provider and investment-related fees charged to 401(k) plans
    - Firms impacted include International Paper, Deere & Company, Lockheed Martin, Boeing, Kraft, Caterpillar, General Dynamics, and United Technologies Corporation.
    - While these lawsuits have focused on larger plans an excessive fee lawsuit was recently filed in connection with a \$2 million plan with approximately 30 participants.

## ERISA encourages delegation to an independent investment fiduciary

- ERISA has always provided a “safe harbor” which limits fiduciary liability where a qualified “investment manager” is appointed.
  - A qualified investment manager is a bank, registered investment advisor, etc. who accepts fiduciary status and discretion over the assets to be managed – in writing.
- If investment responsibility is properly delegated, the plan sponsor will not be under any obligation to invest or manage any assets of the plan that the investment manager is responsible for investing.
- If an independent investment manager is not retained, even a plan sponsor that meets the requirements of Section 404(c) remains fully responsible and liable for the prudent selection of the investment options that are offered to plan participants.

The dangers of  
a non-fiduciary  
model

## Rather than accept delegation, the 401(k) industry has encouraged a non-fiduciary service model

- The major players in the 401(k) industry (mutual fund companies, insurance companies and brokerage firms) have encouraged a non-fiduciary (suitability) model where advisors are:
  - not required to act in the best interests of plan participants; and
  - free to earn variable compensation and other forms of commissions
- In response to fiduciary concerns, the 401(k) industry has promoted
  - reliance on the safe harbor contained in ERISA section 404(c) and encouraged education where plan fiduciaries are told that they can receive complete legal immunity for the consequences of investment decisions made by plan participants;
  - fiduciary education and monitoring services; and
  - the so-called “fiduciary warranty” – *isn't the best warranty that a provider can offer the acceptance of fiduciary responsibility?*

Hiring an independent investment fiduciary for a participant-directed 401(k) plan offers both the fiduciary protection for owners/executives intended by ERISA and the unbiased advice needed by America's workers to maximize their standard of living in retirement.

## The AdvisorPlan Program – the 401(k) platform specifically designed for independent investment advisors acting as fiduciaries of ERISA-covered retirement plan

- Independent Platform - with no hidden agenda - a true unbiased investment approach
- “True open-architecture” and availability of funds offered through custodial platform
  - No investment restrictions -- i.e., no mutual fund revenue sharing requirements for inclusion on the platform
- Full Fee Disclosure and dollar for dollar offset of any mutual fund revenue sharing received to reduce plan and participant expenses
- Global Portfolio Management – rebalance or reallocate all managed accounts at once
- Availability of exchange traded funds (ETFs)
- Ability to work with your local TPA

## About The Advisor Lab

The Advisor Lab, LLC is a technology and education firm dedicated to supporting the needs of fee based financial advisors. The Lab works in affiliation with Professional Capital Services, LLC., and Efficient Advisors, LLC.

## About Bay Point Financial

Bay Point Financial, LLC is a Registered Investment Advisory firm with offices in Bedford and Laconia, NH. Their investment strategies focus on building prudent and efficient portfolios that deliver market returns. They strongly believe this can be best achieved thru proper asset allocation and global diversification with low cost mutual funds and ETF's.

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