No Free Lunch and No Free 401(k) Plans

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Most of us understand that if somebody else picks up the check for lunch, there is probably a catch. The old adage about there being no such thing as a "free lunch" is true more often than not. Hopefully, though, the offset isn't worth more than the cost of the meal.

When it comes to 401(k)s, particularly for small- to mid-size companies with around 100 employees or less and plan assets under $10 million, many employers select the free lunch option when they launch their plan because they want to provide a benefit for their employees but don't necessarily want to write another check. The "catch" for this free lunch includes many of the risks associated with being a fiduciary.

An employer takes on a fiduciary responsibility as soon as the company commits to providing a 401(k) plan as a retirement savings benefit for their employees. Fiduciary responsibility should be viewed as a risk for the company, and deserves the same level of attention as other risks, such as cyber security, data theft and compliance programs. In fact, shifting from defined benefit (DB) to defined contribution (DC) plans is the equivalent of moving the DB liability off the balance sheet while creating a DC risk liability.

A great way to address this risk is to find out how much the 401(k) plan actually costs. Most of us don't ask to see the check to discover the actual price of a free lunch, but your fiduciary responsibility effectively requires knowledge of that information. An outside advisor can identify the costs built into the retirement plan, benchmark those costs to a peer universe and recommend alternatives if better options are available while evolving toward a proactively transparent fee structure. The people working on a 401(k) plan do deserve to be compensated for their efforts, and it's the fiduciary's responsibility to know how much providers are getting paid, along with whether or not that is an appropriate fee.

Fiduciary responsibility for a retirement savings plan includes a number of ongoing requirements to ensure the plan is meeting all of the appropriate legal standards. Key risk areas include plan design, periodic reviews to ensure that the plan is being managed effectively in regard to its investment options and that plan expenses are appropriate for the size and demographics of the company. Most fiduciaries are busy running their company, so the annual meeting to review the 401(k) plan earns a level of excitement and engagement similar to a dentist appointment.

However, in many cases fiduciary risk occurs when a plan is "free" because there are no direct costs associated with it. Many smaller 401(k) plans rely on revenue sharing and other reimbursements to cover plan expenses, but poor disclosure practices create risk as reimbursements become greater than plan costs. A dangerous situation occurs for companies acting as fiduciaries to their retirement plans when neither the plan's costs nor the inherent revenue sharing are fully understood by the employer.

A recent example where the true cost of a free lunch became readily apparent involved a local plan in Minnesota. In mid-May, the LaMettry's Collision 401(k) plan was accused of violating its fiduciary duties to plan participants. The allegations emphasized the inclusion of investment options with high expense ratios that generated revenue sharing for the plan. Questions were also raised about whether or not the plan sponsor was benchmarking the investment options and revenue sharing agreements against other available options (both within the same plan provider or elsewhere).

The LaMettry's case serves as an important reminder about the risk management responsibility that goes with being a fiduciary, along with the value of getting a fresh look at a plan from an outside advisor. Right now is a great time to find out how much your company's retirement plan costs, if better options are available and explore the benefits of a fully transparent fee structure.

Hopefully your company will ask how much its free lunch actually costs before the true check comes due.

About Jay Pluimer, Director of Retirement Services, Flourish Wealth Management, Edina, MN

Jay Pluimer brings over 20 years of experience working with a wide range of institutional investors to Flourish Wealth Management. He has built a career balanced between delivering investment consulting services and supporting the growth of businesses through sales and client service skills. As Director of Retirement Services, Jay is able to combine his consulting and service background to help companies effectively address the retirement planning crisis for their employees.

Jay lives in Minneapolis with his wife (and co-worker) Kathy Longo, along with their three children, Madeline, Fernando and Grace.

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