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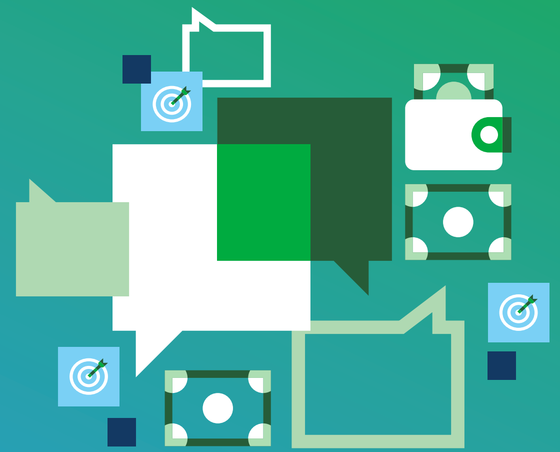
All about 401(k) governance



Q&A with Preston Traverse

The recent COVID-19 crisis and passage of the SECURE Act and CARES Act reinforced the importance of plan governance and defined contribution expertise as plan sponsors and their service providers face increasingly complicated questions.

What were the major challenges for 401(k) plans and their providers during the COVID-19 crisis?

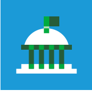
The retirement market was — and will continue to be — tested in 2021. As plan sponsors were digesting the SECURE ACT, they were faced with the initial impact of market uncertainties stemming from the spread of COVID-19 in the United States. Many participants watched their retirement savings plummet at a worrisome rate. Plan sponsors had to explain investment-lineup decisions and, more importantly, make participants understand that investing for retirement requires a long-term horizon.

At the same time, COVID-19 did not stop litigation against plan sponsors. There were eighteen significant settlements within the first quarter of 2021. These covered litigation concerning cybersecurity, proprietary investments, fees and performance. It seems no industry is immune, with a high volume of litigation targeted toward higher education.

Next, the quick passage of the CARES Act required sponsors to make a variety of plan decisions. On face value, adopting the new coronavirus loan and distribution provisions seemed to be the best course of action. In fact, some service providers automatically implemented both provisions unless sponsors actively opted out.

However, we have since learned that these decisions were not so straightforward. The provision allowing loans of up to $100,000 could actually hurt participants if they were eventually laid off, creating a large repayment obligation starting in 2021. The distribution provision enabled immediate access to savings, but in all likelihood, those distributions would not return. This affects not only the participant's retirement outlook, but also the overall plan.

Plan sponsors with access to 401(k) plan expertise were able to consider these impacts. Even more important was having the proper governance structures to vet the decisions and base them on the specific details of their plan and their company's situation. Some plans with these structures in place decided against offering both provisions, and that might help participants avoid depleting their retirement savings or repaying large loans in the future.



What is the future of governance models?

Expertise and strong governance models have become necessities for sponsors in the defined contribution space. The good news is that options for accessing strong fiduciary models has become easier with the passage of the SECURE Act. This legislation introduced Pooled Employer Plans (PEPs) as a way to overcome the challenges cited by small and mid-size businesses in offering retirement plans to employees, such as financial costs and limited organizational resources. PEPs will allow businesses to combine resources and form collective retirement programs, resulting in economies of scale leading to lower costs. PEPs will also reduce plan sponsor risk by transferring most administrative and fiduciary responsibilities from small businesses to third-party pooled plan providers. But while PEPs are a new initiative we already have similar "pooled plan" options available in the marketplace today that are increasing in popularity, which we will reference later.

But small businesses are not alone in their concerns about managing costs, administrative burdens and risks of retirement programs, and the COVID-19 crisis has exacerbated these worries for businesses of all sizes. In countries such as Australia, South Africa and the United Kingdom, where governments have authorized similar pooled plan structures, many larger employers also moved to pooled plans. The advantages of pooled plans, such as lower costs, access to professional and innovative investment management, transfer of administrative burden, mitigation of fiduciary risk and delegation of many day-to-day responsibilities, will broadly appeal to all employers. Larger US plan sponsors are already moving in this direction, and many are now taking advantage of one of the key advantages of pooled plans: delegating their running-the-plan responsibilities.

As mentioned earlier there are a variety of "pooled plan" options, PEPs are one option but there are others that may better suit clients. One alternative is what we refer to as a grouped employer plan, which is very similar to a PEP. In a grouped plan, a number of single-employer plans are grouped together for the purposes of pooling assets and achieving economies of scale. In addition, a provider that offers grouped employer plans will assume most of the administrative and fiduciary responsibilities, just as with a PEP. The SECURE Act also simplified the administration of these plans, reducing the administrative burden related to Form 5500s. (Anyone who has prepared a Form 5500 will appreciate that!)

Plan sponsors should examine all of the different governance models and determine the optimal approach for their organization. The proper structure can also help navigate away from litigation and audit issues. The key is selecting partners with the right experience and resources, allowing companies to focus on their core business while seeking improved outcomes for their plan participants.

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