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Changing the Rules

The Department of Labor recently scrapped a rule that would have allowed brokers affiliated with financial-services firms to provide advice to 401(k) participants. At the same time, Congress may opt to rule on who would be permitted to give such advice. There are some steps HR leaders can take now to prepare their organizations for the new rules.

By Tom Starner

There is no doubt that defined-contribution plans, such as 401(k)s, have replaced traditional pensions in the workplace. But when it comes to providing investment advice to participants in today's "retirement" savings vehicles, uncertainty will be sticking around for a little while longer.

The Department of Labor recently scrapped a rule proposal that would have allowed brokers affiliated with financial-services firms to provide advice to 401(k) participants. At the same time, Congress is moving ahead with legislation that would require that such advice be given by independent advisers.

The DOL rule proposal was one of several DOL regulations issued by the Bush administration in its final days, but squashed minutes after the Obama administration took control of the White House.

According to HR and benefits experts, the Pension Protection Act of 2006 somewhat encouraged employers to hire outside investment advisers to work with employees, but the DOL didn't issue a final ruling on who could provide such counsel to plan participants until January.

At the time, DOL officials explained that using brokers and reps affiliated with financial-services providers to offer advice would give employers access to a larger field of prospective investment advisers. But it also created a potential conflict of interest, since many of the financial-services providers also offer the retirement savings vehicles as well as a full range of services, including providing fund options, assisting companies in selecting funds in the plan and participant education.

HR and benefits experts say the new DOL stance was inevitable and a logical step in sorting out the long unresolved scenario of helping employees make investment decisions within employee-benefits programs.

Karen McLeese, vice president of employee benefit regulatory affairs at Leewood, Kan.-based CBIZ, an HR outsourcing firm, says the DOL action was expected.

"For one, the entire matter of investment advice on the participant level has been an issue ever since individual 401(k) plans became the cornerstone of retirement savings," McLeese says. "If you are going to make people save for retirement, it's a good idea to help them do it. In theory, that means giving them the best educational tools."

But, she quickly adds, when the PPA was enacted, the investment-advice provision was very broadly written and the Obama administration said the DOL's rules not only went too far in favoring the financial-services industry, but it also felt the law itself was poorly written.

"As it stood, the Obama administration believed it needed more checks and balances, more independence and transparency," she says.

The political reality, she says, is that the Bush administration tended to lean in the direction of the employer in the sense that it focused more on giving them the tools to help employees, but there wasn't much push to get the ball rolling. Now, she believes, with the political winds changed, the focus is on the employee.
"One thing is for sure, this is going to cause a lot of investment advisers to revisit their plans," she says. "That, and take a wait-and-see mind-set."

It may be a wait-and-see situation for employers, but employees are already overwhelmed with the task of managing their 401(k) plans.

"With the stock market collapsing and the recession, it created a perfect storm," she says. "The bottom line is people do need advice [for a situation that is] very complex and not easy to fathom."

Matt Smith, senior vice president and leader of the defined-contribution practice in the United States for Aon, the Chicago-based global consulting firm, says this issue has been talked about "forever."

"Investment advice is expensive," he says, "and you have these organizations, record-keeping organizations, that already have connectivity with participants and are in a great position to give advice. But then, there is the potential for conflict."

Smith says he understands the most recent developments, because it is prudent to ensure that plan participants are protected. On the flip side, Smith points out that the percentage of participants who need advice is fairly small. Why? Because the majority of employees don't interact with advice mechanisms, such as computer models or financial planners, he says.

So, while this issue is important, it may not affect as many employees as it would appear to on the surface. He estimates that about 10 percent to 15 percent of plan participants actually use investment-advice services.

Aon has found that a more effective focus for employers is on so-called default options, such as automatic enrollment and automatic increased contributions as well as setting up defaults for investments in balanced portfolios, he says.
That way, fiduciaries can guide many plan participants into decisions that are "financially literate" by default, he says.
"Setting up a balanced fund or target fund for these plans is something you can do right now," he says.

"If you do these things, it's going to cover a good percentage of employees," he says. "Plus, some will have own strategies and don't want advice."

But, at the same time, employers need to communicate the plan to participants, and set it up so people are more likely to use a default rather than using their own judgment in making investment decisions.

Larry Karle, a senior consultant in retirement benefits with Longfellow Benefits in Boston, says the DOL's action along with the current proposed legislation proposed by Rep. Robert Andrews, D-N.J., entitled the "Conflicted Investment Advice Act of 2009," brings into clearer focus what Congress may be ultimately driving towards with regards to participant advice.

"There is no doubt an agreement amongst lawmakers that a greater level of advice is needed for American workers as they save for retirement," Karle says. "The fact that the DOL has dropped the investment advice rule demonstrates that although legislation is necessary, the proposed rules were too complex and cumbersome to be effective."

Karle says the proposed legislation is in many ways much simpler and straightforward and that, while none of the legislation is currently law, there are clear-cut themes that plan sponsors and fiduciaries should be using as potential elements of their plans, so as to put them in a position to succeed when final regulations are approved:

- When it comes to the adviser, the advisers should be true, independent, third-party advisers, and employers should be able to demonstrate that.
- The compensation of advisers should not be affected by the advice he or she gives to plan sponsors or participants.
- The sponsor needs to ensure that the financial adviser will not try to "sell" something to participants.
- The adviser's fee structure must be 100-percent transparent with respect to what he or she earns and how they earn it.

On the vendor/record-keeper side of the house, if the vendor provides asset-allocation modeling for participants, for example, has that model been audited by a third party to determine that the process and methodology is prudent and objective?

"Although currently not required, this could only be a positive in the eyes of any arbitrator or auditor," Karle says, adding that another key point is how often has the model been reviewed and tested.

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