LEGAL UPDATE

Time to Finish What Was Started....ERISA and Fiduciary Process Have Evolved...Have You?

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Over 46 years ago, the Employee Retirement Income Security Act (ERISA) was passed overwhelmingly in the House of Representatives by a 376-4 vote. Congress passed ERISA to empower American workers toward retirement security. Fast forward, on May 23, 2019, the House of Representatives overwhelmingly passed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) by a vote of 417-3. Congress is still passing pension laws by wide margins with bi-partisan support… yet results are suboptimal in terms of retirement readiness.

These laws are intended to protect workers and help millions achieve financial independence. The legislative alignment was there in 1974 and is still here in 2020, but statically interpreted laws alone cannot be the only contributors in place for American workers. To understand what more is needed, let's frame the last 40 years of advisory retirement plan consulting.

After ERISA was passed, the first 401(k) plan came soon after in 1980. That was the beginning of *Fiduciary 1.0*, the ability for 401(k) plans to be offered. Investment companies offered products with very little transparency, quarterly or annual reporting known as "balance forward," and a very limited user experience.

The *Fiduciary 1.0* environment persisted for a couple of decades until the early 2000s saw the rise of the accredited investment fiduciary and other designations. This marked the beginning of the *Fiduciary 2.0* period, where more formalized investment monitoring began to be widely utilized for plan investments, and benchmarking of plan fees and formal fiduciary agreements, such as 3(21), 3(38), and to a lesser extent, 3(16) became increasingly prevalent. Many retirement plan advisors elevated their services from pitching product to offering formal investment advice based on sound fiduciary principles. This formalization of monitoring and oversight was long overdue. Plan sponsors were in dire need of this extra assistance and the *Fiduciary 2.0* period has been tagged as "fees, funds and fiduciary" for the increased awareness of the importance and diligence done regarding such matters. During this period, many plan sponsors hired specialists to document and perform appropriate plan benchmarking, investment performance and cost monitoring.

These advances in plan governance are notable and necessary, but alone do not solve for the elephant in the room. Statistically, it is unlikely that a significant percentage of Americans will securely reach financial independence at a reasonable age. The "three-legged stool" I (and others) wrote about many years ago is still wobbly when you consider the following:[1]

- Auto loans are up 40 percent in the last decade (inflation adjusted).
- Over the last 30 years, health care spending is up 276 percent, housing prices are up 188 percent, tuition at public four-year colleges is up 549 percent, but household income is only up 135 percent.

Middle class income is not keeping up with the costs of health care, housing, cars, and education. Retirement savings for the middle class is slipping down the priority ladder. Perhaps rightfully so, since families need a car to get to work, cannot ignore health concerns, need a secure home to live in, and sacrifice for their children's education. Some middle class families also need to provide financial assistance to elderly parents. Looked at holistically, it all makes sense why the middle class is getting pinched financially.

So here we are in 2020, after an 11-year bull stock market (although because of the pandemic we are in bear market territory now) and after all the advances in legislation and plan design, technological improvements like online enrollment, auto-escalation and so forth… and Americans are nonetheless saddled with the financial obstacles and the majority are "off track" to reach financial independence.

Given the current stock market vicissitudes, this seems like the perfect time to revisit ERISA and the processes around retirement plans, especially considering millions of Americans are likely to fall short of a secure retirement at a preferred age, and that lawsuits are being filed routinely now alleging mismanagement of plan assets. Would a bear market or long stock market correction invite even more litigation activity toward plan sponsors and more financial instability for plan participants?

Procedural and substantive due diligence rule the day. Engaged advisors are moving beyond the *Fiduciary 2.0* deliverables of "funds and fees" to demonstrating, in conjunction with plan sponsors, clear process quantification, although flexibility will be required in the quantification process.

While as a legal matter, ERISA fiduciaries will continue to be measured by their process, rather than results, advisors who can produce measurable results and quantify their value around participant outcomes and process are the leaders.

They will prosper in the Fiduciary 3.0 world which will build upon Fiduciary 2.0 but with an increased emphasis upon retirement readiness, cybersecurity, wellness, and plan participant engagement and education.

The response of advisors to the coronavirus epidemic can provide a concrete illustration of the manner in which Fiduciary 3.0 will function, as well as indicating the real value of an advisor which tends to be overlooked in a lengthy bull market. Providing participants with information about the operation of markets and focusing participants' attention on their long-term time frame will decrease the likelihood that participants will make emotional decisions, such as switching all or most of their investments from equities to fixed income that will have a detrimental effect upon their retirement savings. Advisors can also counsel plan sponsors, who are frequently the named fiduciaries of their plans, helping them avoid rash decisions. Suspension of employer contributions or partial terminations may be unavoidable economic consequences of the pandemic, but a plan termination is not. Some plan sponsors will have special circumstances. For example, in connection with a change in service providers, a blackout period is generally required. A financial advisor's input on how best to proceed in such circumstances, and assisting the plan sponsor in fashioning clear informative advice to plan sponsors, is a further illustration of Fiduciary 3.0 activity.

Service models that can produce robust results for the participants give plan sponsors and plan fiduciaries the best chance to insulate themselves from litigation and liability under ERISA. All these years since 1974, core principles of ERISA remain relevant and might be as important as they ever were due to the financial challenges looming for many employees inside these plans.

The time to be reviewing processes for ERISA plans is now!

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1 *Wall Street Journal*, "Families go Deep in Debt to Stay in the Middle Class" – August 1, 2019 – Andriotis, Brown, Shifflett.