Fiduciary Unawareness May Be Thwarting Defined Contribution Plan Success

By Richard A. Davies

It’s difficult for U.S. defined contribution (DC) plans to improve on their measurements for success if the people responsible for the plans don’t realize they’re responsible. Fiduciary awareness isn’t what it should be. In fact, it’s less than it was several years ago.

It’s no simple matter to keep a DC plan running smoothly. A fiduciary’s duties are many, and many of these duties carry legal responsibilities for plan sponsors. That includes all plan sponsors.

Surprisingly, more than one-third of the respondents to our most recent DC plan-sponsor survey said they were not plan fiduciaries.

That’s troubling, because everyone in the survey actually was a fiduciary, based on their answers to a series of screening questions. Even more worrisome is that the percentage of those who didn’t realize they were fiduciaries has risen from 30 percent in 2011 to 37 percent in 2014, the date of our most recent survey (see figure 1).

Yet four out of five plan sponsors (82 percent) in our survey said fiduciary matters were important or very important, and 70 percent said they believed that all individuals who served in a fiduciary capacity at their plan were aware of their status. Our results suggest they were overly optimistic.

Our latest survey of more than 1,000 plan sponsors (a balanced representation from across the full universe of DC plan sizes) also shows some interesting dividing lines among plan sponsors.

For instance, there was a notable gap in fiduciary awareness among respondents depending on their roles within the company. Human resources/benefits professionals were more likely to say they were not fiduciaries (42 percent) than either senior executives (35 percent) or treasury/finance representatives (32 percent). Also, respondents who said they were part of a plan’s administrative committee were twice as likely as other respondents to be unaware of their fiduciary status.

Plan size made a difference, too. Nearly half the respondents from the smallest plans (those with less than $1 million in assets) didn’t know they were fiduciaries. In contrast, respondents from the largest plans, with their dedicated staff and legal advisors, tended to have a much better understanding of their fiduciary obligations. Using a financial advisor or consultant also made a difference among sponsors from plans with less than $500 million in assets. Those who didn’t use an advisor were more likely to say they were not fiduciaries than those who did (30 percent vs. 18 percent).

It’s also worth pointing out that more plan sponsors took fiduciary concerns seriously when the plan offered target-date funds: 87 percent of such plan sponsors said fiduciary concerns were important or very important, compared to 77 percent of those planning to offer target-date funds and 79 percent of those not planning to offer them. This may indicate that plan sponsors who are more concerned with fiduciary matters recognize the prudence of having a qualified default investment alternative such as target-date funds in their plans.

This brings me to another surprising finding from our survey.

Faulty Defaults Abound
Here is another important area that appears to be impacted by fiduciary unawareness.

[Figure 1: Fewer Plan Sponsors Know They Are Fiduciaries]

Do you consider yourself a plan fiduciary?

<table>
<thead>
<tr>
<th>Year</th>
<th>Yes</th>
<th>No</th>
<th>Don't Know/Not Sure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>61%</td>
<td>39%</td>
<td>0%</td>
</tr>
<tr>
<td>2014</td>
<td>58%</td>
<td>42%</td>
<td>0%</td>
</tr>
<tr>
<td>2011</td>
<td>30%</td>
<td>70%</td>
<td>0%</td>
</tr>
<tr>
<td>2014</td>
<td>37%</td>
<td>63%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Due to rounding, sums may not add up to 100%
Source: AB Research 2014

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According to our survey respondents, a sizeable number of plans lack a default investment or use a default investment that isn’t a qualified default investment alternative (QDIA).

Even though the trend toward greater adoption of target-date funds and other QDIAs continues, some plan sponsors still haven’t embraced the changes ushered in by the Pension Protection Act of 2006 (PPA) and subsequent clarifying regulations. One-fifth of our surveyed plan sponsors said their plans lack a default investment altogether—more so among the smallest plans (37 percent) than the largest (13 percent). Our survey also indicated that another 30 percent of plans still use a stable value or money market fund as the default investment. Surprisingly some plan fiduciaries claim an equity fund as the default (see figure 2).

Our results differ from other industry surveys that focus primarily on larger plans or are based on a single recordkeeper’s data. It is surprising that roughly half our survey population doesn’t take advantage of QDIA safe harbor protections, but the large size and balanced demographic representation of our study make this finding hard to dismiss.

Philosophical Divide in Plan Approach
The lack of a default shows some correlation to the philosophical divide between the “paternal” and “hands-off” plan perspectives.

Plan sponsors with a default were more likely to select critical measures of plan success such as “improving participation” (39 percent vs. 30 percent for those without a default option) and “improving salary deferral amounts” (22 percent vs. 15 percent). They were also far more likely to rate “increasing plan participation” as a highly important goal (60 percent vs. 47 percent).

Respondents whose DC plans don’t have defaults were less likely to offer automatic escalation (21 percent vs. 36 percent for those with a default), and they were more likely to believe that participants want to make their own participation and investment decisions. They were also less likely to have an investment policy statement providing guidelines for fiduciaries on making investment decisions (41 percent vs. 53 percent).

Why Non-QDIA Defaults?
Perhaps plan sponsors don’t fully comprehend the benefits of the Department of Labor’s “carrot” of safe harbor for QDIAs. Or they may fear legal action from participants, although the safe harbor protects them from investment-return liability.

One insight from our study suggests that the use of non-QDIA defaults has more to do with plan sponsors not fully recognizing their fiduciary status or responsibilities. When the default wasn’t also the plan’s designated QDIA, plan sponsors were less likely to consider themselves plan fiduciaries (48 percent vs. 70 percent for those whose default was also their designated QDIA). They tended to rate fiduciary matters as lower in importance (only 33 percent “very important” vs. 56 percent).

In addition, among plan sponsors whose default did not qualify as a QDIA, very few (15 percent) said they plan to change their default to a QDIA in the next two years.

Another barrier may be a lack of familiarity with QDIAs. One in five respondents said they didn’t know if their plan’s default was qualified, and half of the small number of plan sponsors who said an equity fund was their default (in itself hard to believe) mistakenly thought that the equity fund was a QDIA. Two-thirds of those with stable value or money funds as a default said those funds were their QDIAs, even though stable value or money funds are only valid as QDIAs for the first 120 days after participant enrollment.

Training Helps
How can companies turn faulty defaults into pluses for their plans and their participants? Education and training for all plan fiduciaries can go a long way toward instigating beneficial changes for DC plans, regardless of size. Given the large number of plan fiduciaries who don’t recognize or understand their fiduciary status, education should probably be on every company’s to-do list—every year.

Respondents who didn’t consider themselves fiduciaries were more likely to say their organizations didn’t provide training (44 percent, compared to 30 percent of those whose companies did provide training). In fact, companies that provide training for plan sponsors show increased awareness of fiduciary duties by a significant 10 percentage points. As a result, DC plans that work with consultants or financial advisors would do well to ask them for increased plan-sponsor education.

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