

Back to the Future:

THE NEXT GENERATION OF RETIREMENT PLANS

By Michael J. Searcy



WHEN THE EMPLOYEE Retirement Income Security Act (ERISA) began regulating pension plans to ensure their solvency and required firms to follow funding thresholds, the traditional, professionally managed defined benefit plan began to evolve into a defined contribution retirement plan. Reviewing this evolutionary journey and highlighting the various retirement plan structures provides an indication of where the next generation of plans will end up.

Old Method

The participant-directed method of plan management was a swift pendulum swing to the left from where pension plans originally began. The shift from professionally managed plans to a complete maverick system of customization offered the ability to choose and buy different products, leaving participants feeling in total control of their accounts. While empowering, most studies have shown that plan participants did not possess an adequate knowledge of risk and were subjecting themselves to significant exposure to investment loss. Subsequently, few survived the old method unscathed.

Then Package Deals

To reel in the mavericks at heart — and to ease the headaches of trustees and administrators — package deals were introduced, swaying the pendulum slightly back to the right. The limited options given to participants were less

complicated and reduced their exposure to investment risk, but the allure of customization was still present. This format came at a higher cost to the unwary plan participants through the bundled programs, which brought higher fees. In addition to the elevated stated fees, these same bundled programs indirectly added yet another layer of fees — by limiting the investment menus of plan sponsors, fees were increased in the form of reduced earnings of inferior investments and the higher expense associated with them.

To Open Architecture

After realizing the costs and limitations of packaged deals, plans swung further to the right through “open architecture” plans. Open architecture platforms unbundled the costs of the package deals, stripping away some of the layers of unnecessary fees. Further, these plans now afforded the plan sponsors the ability to work with multiple, independent service providers. To some extent, the industry finally returned to the concept of professionally managed plans in which participants were given the flexibility to utilize an array of investments purchased at institutional prices.

Back to Multiple Employer Plans

Most recently, the industry has finally returned to multiple employer plans (MEPs). This shift is characterized as “back to the future” because these plans aren’t new. In fact, MEPs have been around since the origins of ERISA. Steeped in ERISA for decades, MEPs are not only relevant, but also becoming

increasingly popular. All MEPs are not created equal, however, with the right design, these retirement plans can completely eliminate the fiduciary liability for a plan sponsor, provide participants access to professionally managed portfolios for plan participants and typically achieve superior investment outcomes as a result — all at institutional pricing on both the investment management and administration fronts. In the end, properly structured MEPs outsource much of the retirement plan functions and responsibilities outside the plan sponsor’s company and returns that lost productivity to the company.

Fortunately, millions of plan participants will benefit from this retirement plan evolution (open architecture, lower cost investment options and MEPs) and will increase their likelihood of a more successful retirement. Yet, many banks, wirehouse brokers, financial advisors, ERISA attorneys, record-keepers and third-party administrators are not well versed in MEPs and, therefore, do not promote them.

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