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401(k) Fiduciary Newsletter

for Business Owners, Human Resource Directors, CFO's, Plan Fiduciaries and Administrators

Five 401(k) Takeways From Wells Fargo's PR Disaster

Wells Fargo's sales program so incentivized bankers to sell products that bankers illegally used client information to open millions of unauthorized accounts.

"Wells Fargo Fined for Fraudulently Opening Accounts for Customers," The New York Times, Sept. 8, 2016.

Such incentives run rampant in the 401(k) industry, which can put a plan, participants and fiduciaries at risk.

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On September 8, Wells Fargo settled with regulators for $185 million because its bankers used customer information to illegally open millions of bank and credit card accounts. Since 2011, bending to heavy corporate pressure or to achieve bonuses, Wells Fargo bankers took confidential customer information and opened 1.5 million bank accounts and **565,000 credit cards** in their customers' names without their consent. As a result of the bogus accounts, Wells Fargo **terminated 5,300 bankers** and will pay a **$185 million fine**.

To obtain bonuses or avoid termination, bank employees falsified passwords, accessed private information and moved client money without permission. According to E. Scott Reckard, the LA Times journalist who reported on the original law suit filed against the bank, tellers had quotas to refer customers to bankers, and bankers had quotas sell bank products. The bank's actions "severely financially damaged" some customers who were referred to bill collection services as a result of bankers moving customers' money. The illicit practice also harmed customers' credit scores. *LA Lawsuit Alleges Wells Fargo Engaged in Fraudulent Conduct." www.npr.org. May 8, 2015, http://www.npr.org/2015/05/08/405125463/la-lawsuit-alleges-wells-fargo-engaged-in-fraudulent-conduct.*

Wells Fargo managers exerted sales pressure that came down on employees. Tellers were given quotas to refer customers to bankers, and bankers were given quotas to sell products. Regional managers would sometimes call branch managers up to four times daily to pressure the bankers and tellers. Some employees got physically ill from the stress. One bank employee opened 17 accounts for her grandmother to meet her quotas. *Id.*

What does this have to do with 401(k) plans? Plenty. Here are five lessons from the Wells Fargo debacle.

1. Conflicts of Interest are a Significant 401(k) Problem

Conflicts of interest are arguably the biggest dangers 401(k) plan sponsors face. The Department of Labor warns plan sponsors to recognize and understand the conflicts of interest related to their plans. The DOL also recommends documenting those conflicts and why those conflicts do not harm the plan. Most plans do not do this or have any idea how-they rely on service providers and assume those service providers address these issues.

Like Wells Fargo, institutions that sell their own product are heavily incentivized to place those products in your plan. To the contrary, plan sponsors are legally required to use the best products for its plan participants. Using a company's proprietary products exposes a conflict of interest that raises scrutiny on plan oversight. A poorly performing fund that makes a service provider more money will draw more ire than a poorly performing fund that was chosen independently and does not funnel more money to an existing service provider.

2. Proprietary Funds are Sold

Sales pressure can be seen in many plans. Publicly-available 5500 Forms show that thousands of proprietary products are selected for plans. For example, plan fund lineups often have over 50% of the funds from the company who provides administrative or recordkeeping services. The pressure on the institution to sell these products is huge – it is up to the plan sponsor (and the plan fiduciaries) to determine if they are the best offerings. Sales incentives prompted 5,300 bankers to open illegal accounts: fund salespeople will have little problem aggressively pushing their own funds.

3. Proprietary Product Red Flags

Certain proprietary products often found in 401(k) plans are red flags. Stable value funds are almost always offered by the Third Party Administrator and come with risks that FDIC-insured cash products avoid. Stable value funds often require that no other cash product be available to plan participants (which eliminates the ability for a conservative investors to invest in an FDIC-insured product). While these complex products have certain benefits, they were created and are sold to make the institution money. If the name on the product matches the name of the service provider, a plan sponsor better have a detailed analysis of why that product is best for participants.

4. Target Date Funds

Target date funds are sometimes the only proprietary product in a plan. On its surface, that may seem reasonable as participants can choose from many other non-proprietary funds as well. However, many participants select, are encouraged to use, or are automatically enrolled in proprietary target date funds. In this way, the proprietary target date funds get a larger share of investment dollars than other funds. Again, the rule is if a product name match a service provider's name, the plan sponsor should have a detailed report explaining its understanding of the conflict and explaining why a proprietary fund is used.

5. Fiduciary Status Can Limit Recourse

If a plan fiduciary retains co-fiduciary responsibility for selecting funds, they can be sued directly for poor fund selection. If the plan fiduciary deems a fund a poor choice in retrospect, it cannot likely hold the fund seller responsible without admitting the plan fiduciary breached his duty, too.

A plan fiduciary may transfer all responsibility to an advisor (an ERISA 3(38) advisor) to select funds. However, if the advisor selects proprietary funds, a plan fiduciary will not likely avoid responsibility for fund selection. In all cases, a plan fiduciary retains responsibility for hiring and monitoring advisors. Hiring any advisor who may exploit conflicts of interest raise questions as to the prudence of hiring that advisor.

While Wells Fargo's harmful sales scheme is over-the-top outrageous, many institutions provide similar incentives. Such incentive programs can be subtle or not, but it is up to the plan sponsor to recognize such sales programs, that conflicts that exist and the harm that any conflict (no matter how small) may cause.

The easiest way to avoid most of these issues is to avoid the conflicts of proprietary products. A prudent choice may be to use an independent advisor who

- acts as a fiduciary (in the best interests of participants)
- is not incentivized to sell certain product
- helps document selection decisions.