# Life As A 401(k) Plan Sponsor Isn't Fair

By Ary Rosenbaum, Esq.

I think we learn from an early age that life isn't fair. It's probably at an early age when something didn't go our way. While sponsoring a 401(k) plan is a great benefit for your employees, you will realize that the rules for being a plan sponsor aren't exactly fair.

**You wear two hats**

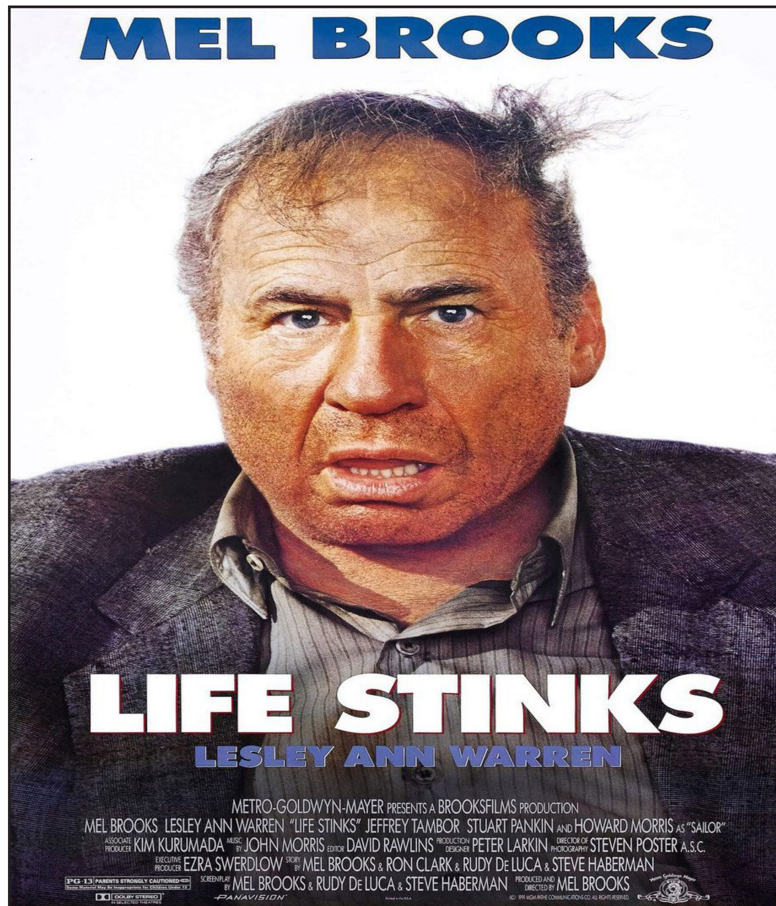
Not only are you a plan sponsor, but you're also a plan fiduciary. You wear two hats for one retirement plan. The nature of being a plan fiduciary requires you to have the highest duty of care in law and equity. What you do with your money is one thing, you need to be more careful when handling the money of your plan participants. Being a fiduciary, means you have to abide by the highest duty of care. So if you're careful with your money, you have to be more careful with the money belonging to others. Like in the movie, This Is Spinal Tap, Nigel Tufnel's amplifier has a volume of 11 (one above 10), consider your care level as a plan fiduciary needs to be at an 11 too. Too many 401(k) plan sponsors have a set it and forget it model of where they set the plan up and never look at it again. I worked at a semi-reputable law firm on Long Island (sorry Lois) where the plan participants never got any investment education and the investment options weren't reviewed for 10 years because the human resources director dropped the ball. Dropping the ball like that would expose you to liability and the problem with being a plan fiduciary is that it may involve personal liability. Unlike health insurance and free coffee, a retirement plan is the one benefit that you can't afford to ignore.

**Hiring plan providers and the liability that goes with it**

I've been an ERISA attorney for almost 24 years and I have heard the lament from many plan sponsors about a costly error caused by the third-party administrator (TPA). I once had a client being accused by the Department of Labor (DOL) of embezzling $3 million, just because of poor advice by the TPA and the failure of them to provide proper valuation reports to the client. That client had decried that they used the TPA for 25 years and just felt a sense of betrayal. The problem with hiring any plan provider is that there is that for the most part, you're liable for the mess that ensues. A TPA is a third-party administrator and not a fiduciary (unless they take on that role), their mistakes will cost you. Sure, you may have them pay for some of the errors because of their negligence, but the buck still stops with you. Even hiring an ERISA §3(16) administrator to be fully responsible for the administration and/or an ERISA §3(38) fiduciary to be fully responsible for the investment component of the plan won't totally free from liability since you're still responsible for hiring them. There is no magic pill that could absolve you from all liability from running your 401(k) plan. All you can do is limit your potential liability and the best way to do that is good practices and hiring good plan providers, as well as reviewing the work that your providers do.

**Goldilocks and cost**

The story of Goldilocks can be boiled down to one thing: finding something that is just right. That is how I feel about the costs of plan providers. For the first half of my career as an ERISA attorney, plan providers weren't required to let the plan sponsor know how much they were directly or indirectly paid for working on the plan. That was a problem because plan sponsors have a fiduciary duty to only pay reasonable plan expenses. So how would plan sponsors know whether the fees they were paying were reasonable if they had no idea what they were? Thankfully, the fee disclosure regulations implemented by the DOL in 2012 went a long way to minimizing the plan sponsor's knowledge gap on plan fees. The part of the retirement plan industry that fought against fee disclosure reasoned that the regulations would force a race to zero where plan sponsors would just pick the cheapest provider. Since 2012, there hasn't been a race to zero, but transparency and technological breakthroughs



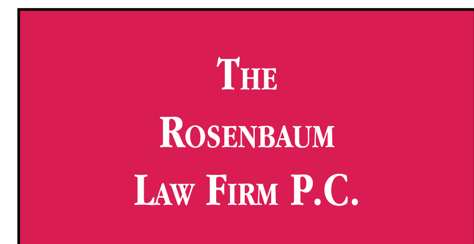

have lowered fees. Like with Goldilocks, fees should be just right. Picking a provider just because they're cheap is a bad idea and you need to remember that there is no requirement that you pay the lowest fees. The requirement is that the plan fees have to be reasonable for the services provided. If you want a higher level of service with more bells and whistles, you can pay more for it. The problem with fee disclosure regulations is that most plan sponsors do nothing with the fee disclosure forms. You can't determine whether your plan provider's fees are reasonable if you do nothing. You need to benchmark those fees by using a research tool such as the 401(k) Averages Book or by seeking out pricing from other providers. You need to document your fee review and keep it in your plan records. I've been on a DOL audit where the agent asked about fee benchmarking.

**The misconception about participant-directed investments**

In the late 1990s, a hot stock market and technology pushed many 401(k) plan sponsors to convert their trustee-directed plan into a participant-directed 401(k) plan. The push was led by mutual fund companies since mutual funds would be the dominant investment option for participant-directed 401(k) plans. The sales pitch was those plan sponsors would be absolved of liability for losses sustained by participants in their own investments. The problem is that it was misleading because it was not explained to plan sponsors that the protection under ERISA §404(c) required them to do something other than allowing participants to invest on their own. The protection of liability under ERISA §404(c) is dependent on providing enough information to plan participants. What does that entail? That means working with your financial advisor to develop an investment policy statement (IPS) that will set the criterion for selecting and replacing investment options. That means sitting with your financial advisor to review your investment options based on the IPS. That also means providing investment education to participants during regularly scheduled meetings. ERISA §404(c) isn't an all-or-nothing proposition, your liability protection is dependent on how diligent you want to be in managing the fiduciary process of the plan and informing participants.

**Highly compensated isn't what you think it is**

In an ideal world, allowing every employee the opportunity to defer in your 401(k) plan would be enough. We don't live in an ideal world. By agreeing to sponsor a qualified 401(k) plan, you agree to act within the confines of the Internal Revenue Code to maintain tax-deferred treatment of plan assets and get deductions for employer contributions you make. One of the basic tenets of qualified retirement plans is that you can't discriminate in favor of highly compensated employees (HCEs). Your definition of an HCE is far different than the one you have to use under the Code. In 2022, an HCE is either a 5% owner of someone that makes $135,000 or more. If you live in a large state like California or New York, $135,000 is hardly an HCE. The problem with a low bar for an HCE is the Actual Deferral Percentage (ADP) Test for salary deferrals. The ADP test compares the average salary deferral percentage between HCEs and non-highly compensated employees (NHCEs). To pass the test, the ADP of the HCEs may not exceed the ADP of the NHCEs by more than two percentage points. Also, the combined contributions of all HCEs may not be more than two times the percentage of NHCEs' contributions. If the plan fails, you would either have to make a contribution to make the test pass or make taxable refunds to HCEs, which would be unpopular. Another similar test that may require employer contribution is the Top Heavy Test. Your plan would be considered to be top-heavy if more than 60 percent of plan benefits are in the accounts of key employees. An employee will be identified as a "key employee," if at any time during the plan year that employee is an officer with annual compensation exceeding $200,000 for 2022 (subject to cost-of-living adjustments each year), more than a five percent owner, or more than a one percent owner with annual compensation exceeding $150,000 (not subject to cost-of-living adjustments). Offering a plan and giving all your employees the right to participate (after meeting the eligibility requirements isn't enough.

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