Concepts You May Not Be Aware Of As A 401(k) Plan Sponsor

By Ary Rosenbaum, Esq.

As a child, I was never taught the birds and the bees. I was actually handed some cartoon book from my parents when I was young. My parents thought it was hilarious that they had to hand me a book about where I came from even though I had already guessed right. As a 401(k) plan sponsor, you're always on the end of a sales pitch and you may not understand some basic, eye opening concepts about your 401(k) plan. While I don't have a cartoon book for you to understand your role as a 401(k) plan sponsor, this article will make you understand some interesting concepts that you had no idea of until you read to the end.

You're on the hook for liability

As a 401(k) plan sponsor, you need to hire plan providers to handle the plan administration, fiduciary process, and legal components of your plan. If you're required to attach an independent audit for Form 5500 because you have a large plan, you'll have to hire a CPA firm too. So while you hire these professionals, just remember that you're still on the hook for liability for hiring these plan providers. Why? As a plan sponsor, you're also a plan fiduciary, so you need to hire good plan providers because you're on the hook for hiring them and you're on the hook for the mistakes they make. So many plan sponsors like yourselves have learned the hard way that when the third party administrator (TPA), financial advisor, or ERISA attorney screws up, you're going to foot the bill. If your TPA fails to file your Form 5500 on time, you're the one who gets the penalty letter from the Internal Revenue Service or Department of Labor. Even if you hire a plan provider who is supposed to assume some liability for plan administration if they serve as an ERISA §3(16) or assume all liability for the fiduciary process as an ERISA §3(38) fiduciary, you'll still be on the hook for liability if they went rogue. While you can always minimize your fiduciary liability through good practices, hiring good plan providers, and even delegating to certain ERISA fiduciaries, you can never fully eliminate your liability as a plan fiduciary.

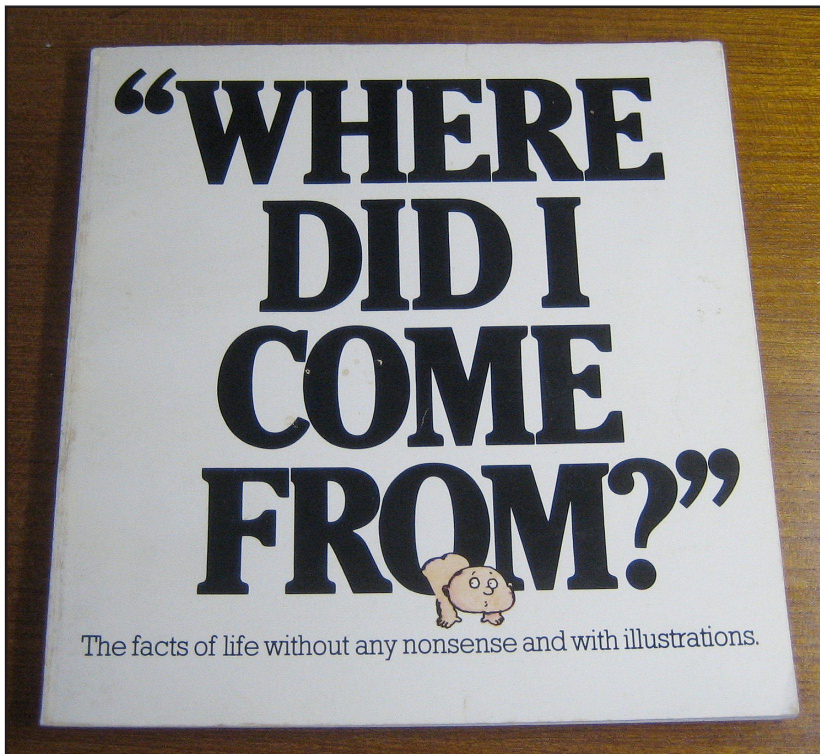
The most important provider is your TPA

I'm an ERISA attorney and I think I do a swell job, but my ego isn't big enough to suggest that I'm the most important plan provider you should hire. While I think I'm pretty good and I think you should hire me because I'm good and I charge a flat fee, the most important provider you hire is your TPA. While I think financial advisors are great, the TPA is the most important choices because the many headaches associated with running the plan are caused by TPAs who don't do a great job in helping you administer the plan. A TPA does all the compliance testing, allocations, trades, plan document and design work, and files the Form 5500. With so many intricate duties that a TPA performs, mistakes can happen. A good TPA will make fewer mistakes than a bad TPA and most issues deal with the compliance part of the plan that a TPA handles. That's why it's extremely important to hire a good TPA.

ERISA bonds and fiduciary liability insurance are two different things

Every ERISA plan requires what we call an ERISA bond. An ERISA bond protects plan assets from theft by plan fiduciaries such as a plan trustee or a financial advisor that serves as a fiduciary. It's required and you have to answer whether you have the right amount of coverage on Form 5500. An ERISA bond does not protect plan fiduciaries when they get sued by aggrieved plan participants. That form of protection is a fiduciary liability policy. Unlike an ERISA bond, it's not legally required. However, I recommend that you buy that coverage because being a plan fiduciary such as a trustee may involve personal liability and there is nothing worse than to pay out of your own

pocket to defend yourself in your role as a plan fiduciary.



You can be liable even if participants direct their own investments

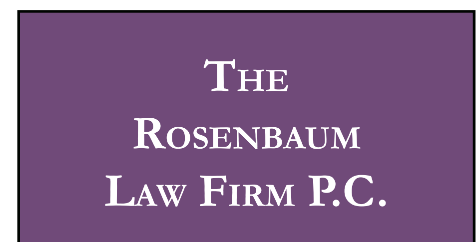
One of the beautiful aspects of participant directed 401(k) plans is the notion that ERISA§404(c) may limit your liability for any investment losses sustained by the participants. The magic word is "may," because the marketing of these participant directed 401(k) plans made you think that the liability protection under ERISA §404(c) was an absolute blank check of liability protection. It isn't. Like I always say, ERISA §404(c) isn't a suicide pact, it's not an all or nothing proposition. The liability protection under ERISA §404(c) is really a sliding scale of liability protection. As long as there is a prudent process in selecting and replacing the investment options in your plan and as long as you provide participants with enough information to make investment decisions, you should be protected from liability for the investments made by plan participants. So that means you have to sit down with your financial advisor on a frequent basis to review investments to see whether they should be retained or replaced based on a previously selected criteria which we call an investment policy statement. It also means that you have to provide at a minimum, investment education to plan participants. The investment policy statement and investment education aren't legally required. However, like brushing and flossing, these are great practices, and they can go a long way towards limiting your liability under ERISA §404(c). If you do nothing to help yourself here, you're going to find out the hard way that you have no blanket protection under ERISA §404(c).

Too many choices on an investment lineup is a bad idea

We learn from an early age that choice is a good thing. It's part of the American spirit that there is a freedom of choice. Maybe that explains why there seems to be 65 different varieties of Cheerios when I only grew up with two. We were grown up to think that choice is a great thing. As a plan sponsor, you probably assume that the more investment choices on a 401(k) investment lineup, the better. If you thought that, you'd be wrong. Actually, too many investment choices on a 401(k) investment lineup where participants direct their own investments are a terrible idea. The reason why it's a terrible idea is that studies show that too many choices on an investment lineup actually depress participation of employees in deferring their salary. Surprised? A 401(k) lineup shouldn't be treated like the buffet at Golden Corral because too many investment choices actually overwhelm participants. Having five large cap growth mutual funds for participants to choose from may sound like a great idea, but participants get so overwhelmed by the choices that it sets in a paralysis where they decide not to bother with participating in the plan. Too many choices create confusion, so a lean investment lineup will actually spur employee participation in the salary deferral component of the plan. It's a hard concept to grasp, but you need to understand that we're talking about human nature and plan participants don't want too much choice and too much information. Just remember that less is actually more when it comes to the investment lineups offered under a 401(k) plan.

Fees only have to be reasonable

Thanks to litigation and regulation over the last few years when it comes to fee transparency, most of you have been trained to consider and understand the fees that are being charged to administer your 401(k) plan. You're told through disclosures what fees are charged to your plan and you need to make sure that plan participants get that information as well. You also need to make sure that you actually benchmark the fees disclosed on those fee disclosures. What really is glossed over when it comes to the discussion about fees is that you only have to determine whether the fees being charged to your plan are reasonable for the services provided. You have a fiduciary duty to only pay reasonable expenses. That means that you have no duty to pay the lowest fees. From experience, I think it's a breach of a fiduciary duty just to pick plan providers who charge the lowest in fees. The reason why? There is sometimes a cost for no-frills services, perhaps in quality and competency. The fees have to be reasonable for the services provided, so that means you have pay white glove prices for white glove treatment, you can't pay white glove prices for no-frills treatment. There are many reasons why you should select a certain provider, just remember that the fact that they charge the lowest fee out there isn't a requirement.



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