Pitfalls A 401(k) Sponsor Can Avoid With Plan Providers

By Ary Rosenbaum, Esq.

Much of the focus concerning the liability of sponsoring a 401(k) plan is about plan expenses, thanks to the many lawsuits filed against plan sponsors. However for most plan sponsors, the greatest liability they actually face is resulting from the plan providers they hire. There are many plan providers and some of them aren't very good and the not so very good ones cause a lot of headaches and costly bills for the 401(k) plan sponsors that hire them. This article is about the pitfalls that plan sponsors can avoid in hiring plan providers that could cause liability.

Why it matters who a plan sponsor hires

Companies hire service providers all the time and if things don't work out, the company learns its lesson and hires another. Well the problem is that a retirement plan sponsors isn't so lucky if they pick a bad plan provider. As a fiduciary, a plan sponsor is ultimately responsible for what a bad plan provider does. That's the nature of being a fiduciary; a plan sponsor has more responsibility and liability because they're holding the retirement assets of their employees. So being responsible for someone else's money does require a greater level of responsibility. As Uncle Ben told Peter Parker: "with great power, comes great responsibility." So if a plan provider such as a third party administrator (TPA) fails to file a Form 5500 or a financial advisor fails to help the plan sponsor select investment options, the 401(k) plan sponsor is still ultimately responsible for them because the buck stops with them. Sure a 401(k) plan sponsor would have recourse to sue a plan provider that goes wrong, but that's little solace after a plan sponsor bears the responsibility of fixing the errors made by their third party provider.

Looking at more than one plan provider.

When it comes to selecting a plan provider, it makes sense for the 401(k) plan sponsor to consider more than one provider to hire. So that means when hiring a TPA, a plan sponsor should look at more than one TPA, the same with financial advisors. Checking more than one plan provider will give the 401(k) plan sponsor a better understanding of what plan providers can offer. When you hire a contractor to work on your home without considering others, you run the risk of hiring a bad one and/or paying more than you should. So a plan sponsor would be wise to consider more than one plan provider at a time to hire.

Checking out the plan providers being considered

Many years ago, I realized that I needed waterproofing in my home through the addition of a French drain. I found waterproofing companies online and I failed to vet them. So I hired a company after meeting with their salesman who gave me a great deal on a French drain system. They installed the system and then the battery backup caused a deafening alarm. The company refused to fix it and I eventually had to file multiple complaints with the Nassau County Department of Consumer Affairs. Had I bothered to check on Nassau County's website or the Better Business Bureau, I would have discovered that the company had multiple complaints against them and the man running the company lost his license as a podiatrist for Medicare fraud. So considering a number of plan providers

isn't enough, it's important for the 401(k) plan sponsor to vet them. If the plan provider that is being considered is a financial advisor, it's easy to check whether the financial advisor has had any disciplinary issues, the same with an ERISA attorney. For a TPA that's a little harder since there is no reporting or licensing agency. So a plan sponsor would need to investigate my searching online or seeking out guidance from other types of plan providers on the providers they would recommend or avoid. As an ERISA attorney with almost 19 years experience, I can certainly tell which TPAs are good and which aren't.

Benchmarking Fees

A 401(k) plan sponsor seeking out plan providers should not only consider their competence, but also the fees they charged. So not only do plan sponsor need to hire competent plan providers, they have the fiduciary duty to only pay reasonable plan expenses. That was the requirement before and after the implementation of fee disclosure regulations that required plan providers to disclose the fees they were charging to retirement plans. Reasonableness is based on the services provided, so that doesn't mean that a 401(k) plan sponsor has to select the cheapest provider. However, reasonableness isn't an opinion, it has to be based on what other plan providers charge for similar services. So that means a 401(k) plan sponsor would have to benchmark fees charged by a plan providers against what other similar providers charge for the same level of service. This can be done by seeking pricing from similar plan providers or using some type of service to benchmark fees. Regardless of how it's done, benchmarking is something that a 401(k) plan sponsor needs to do.

Reviewing plan providers after they're hired

One of the biggest problems with plan errors caused by plan providers especially the TPA is that it's usually not discovered until there is a change of plan provider. Most plan errors especially on the plan administration side only come to light when the 401(k) plan sponsor changes TPAs. In the movie Casino, Sam Rothstein says there a lot of holes in the desert where disputes and bodies are buried. There are a lot of plan errors that get buried and they're only discovered many years later with nice penalties to boot for fixing them. I have a recent client where the previous TPA never did a Top Heavy test and the plan sponsor had absolutely no idea. So many errors in deferrals, testing, and allocations are discovered long after they are first made. How to avoid that kind of a problem? Using other plan providers such as an ERISA attorney as yours truly or an independent retirement plan consultant to review the work of plan providers. For example, I charge $750 for a plan review where I look at the work of plan providers and try to root out any issues and problems that the plan sponsor is unaware of. The only way to determine whether a plan provider is doing a credible job or not is to actually have them reviewed.

Finding a plan provider that fits and getting rid of them when it doesn't

There isn't a plan provider out there fir everyone. Every TPA, financial advisor, auditor, and ERISA attorney serves certain parts of the marketplace. So a 401(k) plan sponsor needs a plan provider that fits the needs of the plan and replace them when the plan has outgrown the plan provider. A small safe harbor 401(k) plan maybe a nice fit for a payroll provider TPA, but when the plan grows and there maybe an interest on a cross tested design or an additional cash balance plan, they probably need a new TPA that could properly serve the plan. A financial advisor who was a great fit for the plan when it was small may not have the ability to serve plans that are larger in scale. Every retirement plan provider serves a niche in the market and if the 401(k) plan no longer fit that niche, a change of plan providers is necessary.

Selecting a plan provider needs to above reproach

Nepotism and cronyism are hallmarks of politics; they have no business in the selection of 401(k) plan providers. If you want hire your brother as an electrician, that's fine. 401(k) plan sponsors as fiduciaries don't have that luxury. Everything they do can be held under a microscope, so the selection of a plan provider must be above reproach. Hiring certain family members as plan providers can actually be prohibited transactions because they financially benefit a plan fiduciary. Hiring a plan provider because they're a relative or they offer a line of credit through a bank subsidiary or for any other reason that isn't on the up and up is something they should avoid.

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