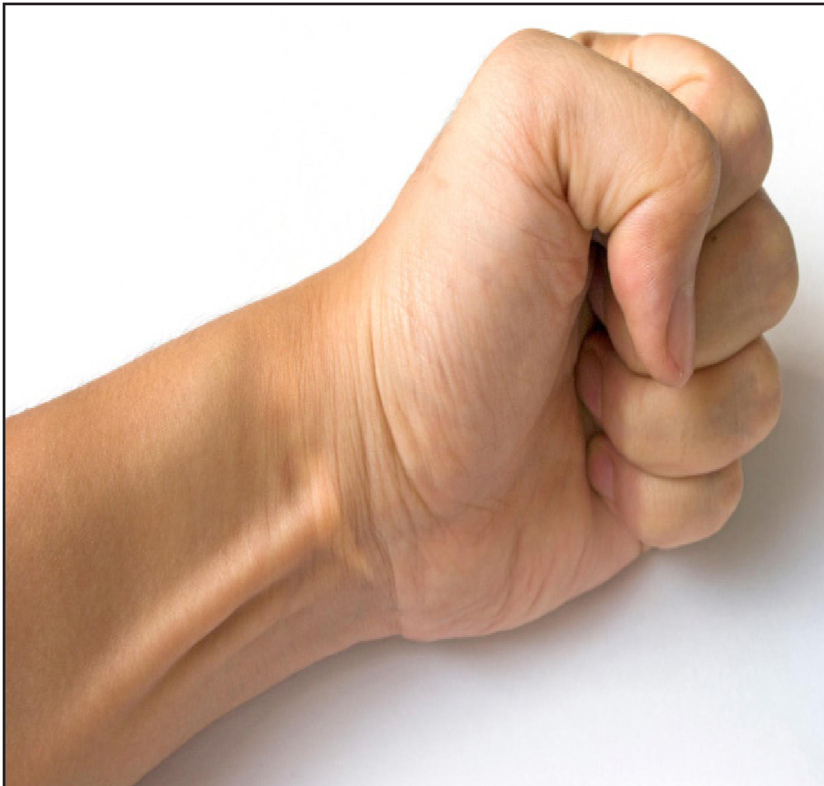
It's Time For 401(k) Plan Sponsors To Get A Grip

By Ary Rosenbaum, Esq.

As an ERISA attorney with a national retirement plan practice, I often feel like a flight attendant giving the safety discussion on a commercial airplane. When I talk about retirement plans and fiduciary liability, I think half the audience of plan sponsors tunes me out. Like the safety discussion on an airplane, those instructions are important to know before something goes wrong. This article is about how plan sponsors need to get a grip and a handle on their 401(k) plan.



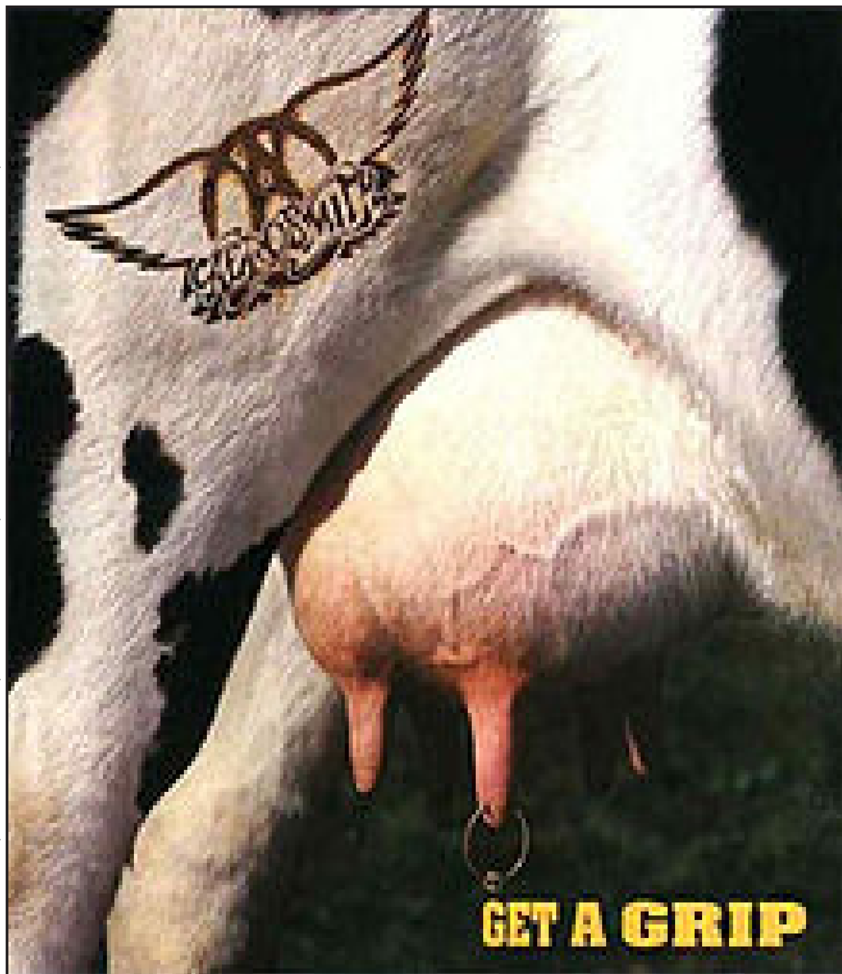
Get a grip. Why now?
ERISA went into effect in 1976, so many of the responsibilities that a retirement plan sponsor had was already disclosed in that law and the regulations promulgated by the Department of Labor (DOL) to supplement that law. Retirement plan sponsors including 401(k) plan sponsors had a laissez faire attitude towards their responsibilities and the DOL did very little against plan sponsors unless there was a theft of plan assets. However, there was an evolution or revolution of sorts and concerns about the cost of 401(k) plans finally reached to the surface thanks to two bear markets in the 2000s. When everyone is making money in the market and in their 401(k) plan, there doesn't seem too much concern over plan fees.

They need to know their fiduciary responsibility
Why should plan sponsors get a grip? Well, not only do they sponsor their 401(k) plan, they're also plan fiduciaries. So that means they have the highest duty of care in law and equity because they are responsible for the retirement plan assets of their employees. So while they could be careless with their own money, they'll be liable if they're careless with the money belonging to plan participants. They also have to be careful in everything they do including hiring their plan providers because the buck stops with them. Fiduciary liability can involve personal liability. Just ask a plan sponsor in Mississippi who has to fork over three of his personal cars to make good on a multi million judgment against him.

The focus on fees
Thanks to the trouble in the markets, there was certainly a clamor of support in mandating some type of required fee disclosure by plan providers to plan sponsors. Too much of plan costs were cloaked by certain plan providers including third party administrators (TPAs) and bundled plan providers such as insurance companies that so many plan sponsors thought they were paying nothing for plan administration, but plan participants were paying through the nose which took a bite out of any investment gains that a plan participant could make. While Congress didn't want to institute any fee disclosure regulation because of the influence they received from Wall Street in terms of campaign contributions, the DOL instituted their own form of fee disclosure regulations in 2012. The regulations mandate that any provider who received directly or indirectly $1,000 or more in fees needs to provide a fee disclosure annually to the 401(k) plan sponsor. Of course, the sky didn't fall on the retirement plan industry as some people predicted and fees have been going down as a percentage of plan assets over since. The problem with the fee disclosures is most plan sponsors do absolutely nothing with the disclosures they receive. Since they have a fiduciary duty to only pay reasonable plan expenses, it's an absolute mistake for plan sponsors just to throw the disclosures in the back of a drawer or throw them in the garbage. The only way to prudently exercise their duty to pay reasonable plan expenses is for the plan sponsors to actually benchmark those fees. A plan sponsor doesn't have to pay the lowest plan expenses and picking plan providers just because they're cheap is a recipe for disaster. A plan sponsor needs to determine whether the fees that the plan is paying are reasonable for the services provided. So a plan sponsor needs to benchmark fees by checking out competing plan providers or use benchmarking services.

The focus of mutual fund share classes

Thanks to some very creative ERISA litigation, plan sponsors need to focus on the share classes of the mutual funds offered in the plan. Most mutual funds offer different share classes with different levels of fees. Usually, the largest 401(k) plans would have access to the lowest cost share classes available as long as the plan sponsor and their financial advisor made the switch. If a plan sponsor doesn't pay attention to share classes, they may be in a share class of a fund that may be too expensive for a plan of that size if a cheaper share class of that same fund is available. Plan sponsors can be held to violate their fiduciary responsibility of prudence if plan assets are in a share class of a mutual fund when a less expensive share class of that same fund is available. So in a sense, a plan sponsor can violate their duty of prudence if they pay "retail" for a fund when it was available "wholesale". Plan sponsors need to sit down with their advisors and determine whether the cheapest share classes are available for the funds offered under the plan.



The "force" of the DOL awakens

Thanks to fee disclosure regulations and a commitment to better serve plan participants, the DOL, under Assistant Secretary of Labor for Employee Benefit Security Phyllis Borzi, has shown great interest in what plan sponsors are doing. They have hired more auditors to perform more field examinations (audits) of plan sponsors. The DOL wants to make sure that plan sponsors are performing their fiduciary duties diligently. The DOL is asking plan sponsors for things they never asked for, such as whether they have an investment policy statement for the plan or whether they offer education to participants. The DOL wants to see if plan sponsors are reviewing fee disclosures, handing out required notices, and doing everything they're supposed to under ERISA. So if the DOL is looking, in addition to the audits by the Internal Revenue Service, plan sponsors certainly need to get a grip.

The IRS has always been there

To be qualified under the Internal Revenue Code (Code), the plan sponsor must operate the plan according to its plan document and the Code. That means that the plan sponsor must make sure the plan complies with the Code. In order to ensure compliance with the Code, the Internal Revenue Service (IRS) does conduct random audits of 401(k) plans. The problem is that many compliance errors done in the administration of the plan by the TPA and/or the plan sponsor comes to the surface. While the IRS has a voluntary compliance program for plan sponsors to correct errors voluntarily with little or no penalty, that forgiveness doesn't extend to any errors discovered under an audit. Even if the TPA is responsible for the error, it's going to be the plan sponsor on the hook for the error. That's why a plan sponsor should hire an ERISA attorney like yours truly or an independent retirement plan consultant to make sure compliance testing is done correctly and that there won't be any unwelcome surprises in case of a plan audit.

Litigation, litigation, and the threat of litigation

There has been an explosion of litigation against 401(k) plan sponsors The reason is because the Supreme Court made it easier for plan participants to sue and the issues of fees has been something that ERISA litigators have concentrated on. While the large class action lawsuits target large 401(k) plans of large businesses, the threat of litigation is always there for a 401(k) plan of any size. Years ago when I started my practice, I talked about the litigation threat against 401(k) plans of all sizes. I was told at the time that I was just selling fear because medium and small plans weren't being sued. While medium and small sized plans don't get sued in a class action, they have been getting sued every now and then of late. A class action lawsuit is the least of a plan sponsor's legal worries. There can be litigation by an aggrieved plan participant or a disgruntled employee who needs an excuse of 401(k) litigation as revenge for being fired for cause. There also can be litigation by the DOL or IRS if the plan sponsor runs afoul of ERISA and the Internal Revenue Code.

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