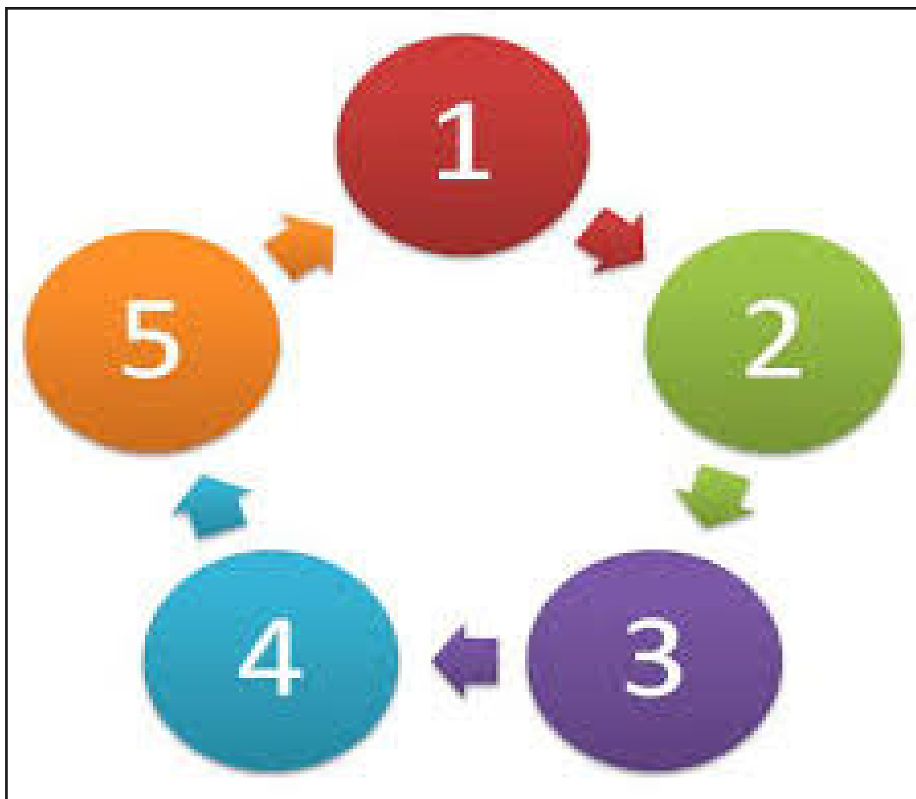
How a 401(k) Plan Sponsor Minimize Their Liability In 8 Easy Steps

By Ary Rosenbaum, Esq.

Sponsoring and operating a 401(k) plan isn't easy. A plan sponsor can't just set up the plan and forget it. They need to constantly be on the watch because of the liability exposure they have as a plan sponsor. When plan sponsors are told about their duties in operating the plan, they zone out. So here is a breakdown of what plan sponsors need to know in order to curb their potential liability as a 401(k) plan sponsor. They can minimize their liability by just following these 8 easy steps.



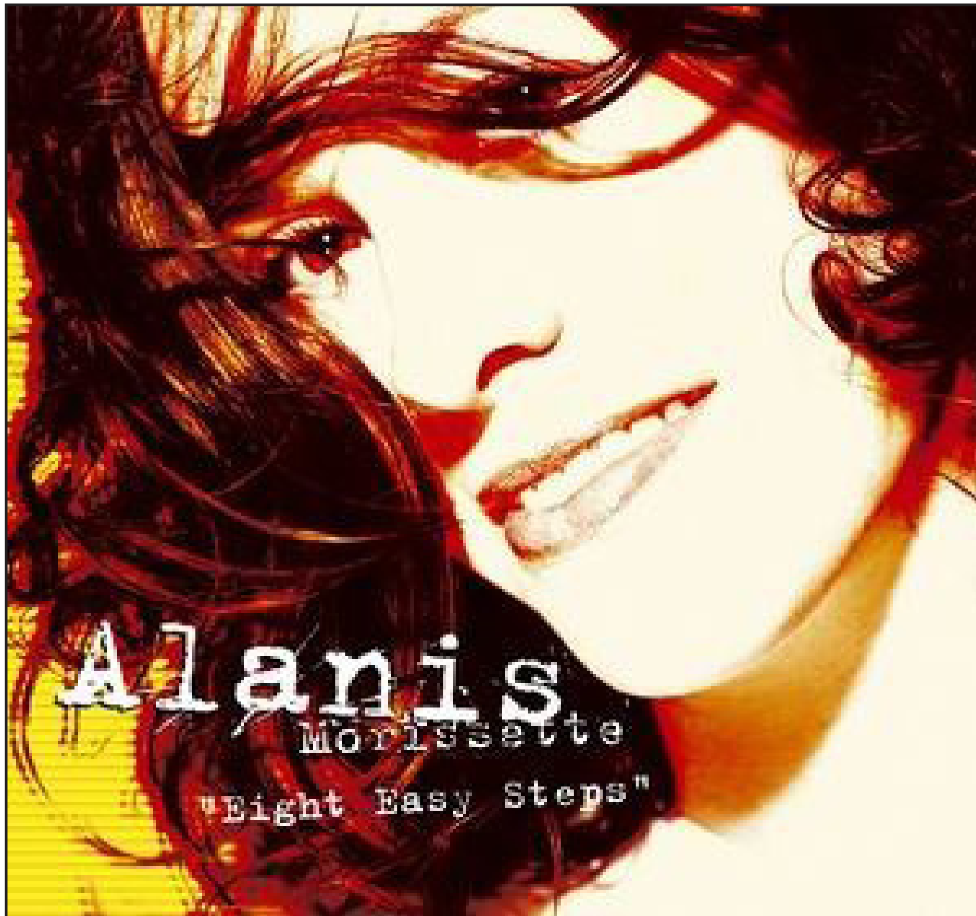
Understanding the role of a fiduciary: Unlike other employee benefits, a 401(k) plan sponsor has a bigger role than just sponsoring the plan. Being a plan sponsor also means being a fiduciary. As I always say, being a fiduciary requires the highest duty of care in law and equity. That means a plan sponsor needs to be more careful about money belonging to their employees than they do in handling their own money. Plan sponsors also need to understand that if they don't exercise their fiduciary duty in a diligent manner, they may be liable for damages that will hurt them in their wallet.

Hire the right plan providers: I live on Long Island, close to New York City which is a mecca for the best in health care. So I'm always amazed when people who are ill with cancer or some other serious condition, just go to their local rinky dink hospital when experts in the field are just a drive or train ride way. That's the way I feel about using retirement plan providers. Rather than using someone just because they're local, someone's relative, or someone just because they're cheap, a plan sponsor should hire the best provider out there. That means people who know what they're doing and charge a reasonable fee for the services provided. The providers selected need to be experienced when it comes to working with retirement plans, so there is no room for tryouts. Plan sponsors need to understand that picking incompetent providers is their headache as a plan sponsor because they're going to be on the hook for liability for any errors made by these providers.

Focus on finding the right third party administrator (TPA): I talked about finding the right provider, so why do I mention that plan sponsors need to find the right TPA? For emphasis, because the TPA is the most important plan provider that a plan sponsor could hire. The reason they're the most important plan provider because of the amount of work they do with compliance, recordkeeping, and plan design. A terrible TPA can cause compliance errors that put the 401(k) plan at risk for fines, penalties, and corrective contributions by the Internal Revenue Service (IRS) and/or the Department of Labor (DOL). Failure to properly administer the plan could always lead to plan disqualification by the IRS. A good TPA will also be an expert at plan design, which is an important thing to consider because they can help with maximizing contributions as well as making them more efficient for compliance requirements. Plan sponsors have regretted choosing a TPA just because they're cheap or just because the TPA also handles their payroll or because they love the TPA's proprietary mutual funds.

Getting insurance: While all plans covered under ERISA require an ERISA bond to protect the theft of plan assets by plan provider, that is a complete and separate policy that should not be confused with fiduciary liability insurance. Fiduciary liability insurance is all about protecting the plan fiduciaries, which includes the plan sponsors, the trustees, and anyone who could be a considered a fiduciary for plan purposes. The reason why fiduciary liability insurance should be purchased is that fiduciary liability may

involve personal liability. While fiduciary liability insurance isn't required, plan sponsors would be wise to purchase it. I'll never forget hearing about a plan sponsor with $1 million in legal bills after being sued in a case they won, but the blow was cushioned after fulfilling the $100,000 deductible with the insurance company picking up the rest.

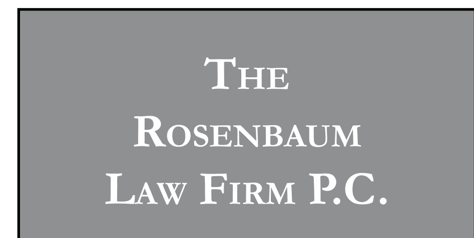


Reviewing fee disclosures and benchmarking fees: For the past few years, DOL regulations require plan providers who charge $1,000 or more to the 401(k) plan for plan services to furnish fee disclosures to plan sponsors. Too many plan sponsors just take a quick look and throw it in the garbage. The fee disclosure requires plan sponsors to diligently review their fees and benchmark them. The reason why the quick toss to the garbage pail is a bad idea is because a plan sponsor has the fiduciary duty to only pay reasonable plan expenses. The only way to determine whether the fees are reasonable for the services provided is to actually benchmark them against what other providers are charging for the same services. That means shopping the plan around to competing plan providers or using a benchmarking service. The cost of plan investments also has to be reviewed, just to make sure that the lowest cost share class of the investments in the plan are offered, based on the size of the plan.

Have the plan reviewed by an ERISA attorney or independent consultant: A plan sponsor can't assume their plan providers are doing a great job because like I stated before, it's the plan sponsor that is on the hook for liability if something goes wrong. The big problem with something going wrong is that if a plan provider doesn't disclose the error they caused, it usually is discovered under a plan audit by the IRS or DOL or when the provider is replaced and it's discovered during a provider transition. Since reviews of the plan by the current providers may be self-serving, it's important that plan sponsors get an independent plan review from an independent retirement plan consultant or an ERISA attorney like yours truly. Not to promote myself (except this article is promoting myself), I do an independent review called the Retirement Plan Tune Up where I review the plan from top to bottom for $750, which can be charged against plan assets.

Communicate with plan participants: Plan sponsors can avoid a lot of liability by simply interacting with participants when it comes to the 401(k) plan. That means providing plan participants with education so they can make informed investment decisions if they direct their own investments. That means also giving them all the required summary plan descriptions and notices required by ERISA. It also means operating the plan according to its terms especially when it comes to distribution of benefits. Plan sponsors forget that a plan is an employee benefit and it's important not to ignore the employees when it comes to this retirement benefit.

Keeping good records: A 401(k) plan is a qualified plan under the Internal Revenue Code and is an employee retirement plan subject to ERISA. It's a legal entity and when it comes to anything that deals with legal requirements and consequences, it's extremely important for the plan sponsor to keep good records. That means keeping copies of all plan documents. That means keeping all the valuation reports produced by the TPA. That means keeping minutes of all meetings attended by plan fiduciaries. That means making sure that investments selected and replaced are done according to an investment policy statement. That means keeping attendance at all participant education and enrollment meetings. That means keeping copies of all notices and investment education materials. I call it papering the process because what keeps a plan sponsor out of trouble is following a prudent process of operating the plan, it doesn't require any other type of result.



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