They Say Their Plan is OK, But Plan Sponsors Usually Have No Idea

By Ary Rosenbaum, Esq.

When I was dating my wife, she asked me if I had a good credit score and I said I did. I never checked my credit score, but I paid all my bills in full and on time. Of course, when I got a copy of my credit report, my credit score wasn't so great because that credit card account that I opened in college with my mother had a $17,000 balance that I wasn't aware of since I didn't use the card for about 9 years. My wife was upset because she thought I made an affirmative statement without really knowing the actual truth. Plan sponsors do that all the time when they tell retirement plan providers that their 401(k) plan is OK without having any background or information to make that affirmative statement. Plan sponsors can claim that their 401(k) is fine, but that doesn't mean that's true. So this article is to show 401(k) plan sponsors the idea that their plan is in good shape may not be grounded in reality.

The bookkeeper (or some other employee) says the Plan is OK

Prospective plan providers actively solicit plan sponsors because they want to recruit more clients, that's how they become bigger and increase revenue. Most plan sponsors really don't want to talk about their retirement plans because they're busy and 401(k) plans aren't an exciting topic for them despite all the potential liability that goes with being a retirement plan sponsor. Many businesses are large enough where the owner of the company isn't the go-to person for the retirement plan. It might be the human resources director and/or the bookkeeper. So these businesses will tell a prospective plan provider that they don't need their services because the bookkeeper or some other employee told them the plan is fine. Unless these employees have some retirement plan administration experience, that answer is probably insufficient because that bookkeeper or other employee doesn't really know that the plan is fine. Saying the plan is fine is kind of like the stock answer I say to my wife that I'm listening when I'm really not. I'm not trying to suggest a company's employee is lying, that may be what the plan provider is telling the employee. The point is that unless the employee is a retirement plan expert, their comment that the plan is OK isn't something that should be relied on because the comment may be based on information provided by a plan provider or just something the employee said to end the conversation. Regardless, a plan sponsor shouldn't rely on the opinion of an employee who isn't a retirement plan expert.

The plan provider says the Plan is OK

One of the most asked questions is: "how do I look?" 99.9999% of the time, the answer is that you look OK, good, or anything positive. People don't like negativity and many times, they just want a positive comment as a reassurance. It's like when school teachers tell me how wonderful my kids are, do they actually tell parents when their kids are horrible and are the second coming of Damien from The Omen? I assure you that they don't. The problem with saying that a plan provider is telling a plan sponsor that their plan is OK is that the plan sponsor doesn't have the assurance that the answer could be relied on. Like "how do I look", I think 99.9999% of plan providers will tell the plan sponsor that the Plan is doing great or something else positive when asked about how the plan is doing. Most plan providers are very good at what they do, so those good plan providers are likely honest when they tell the plan sponsor. For the bad providers who make many compliance mistakes (that usually go undetected until a plan provider change or Internal Revenue Service audit), they aren't going to tell you that the Plan is doing anything remotely negative because they're not going to tip their hand that they're doing an awful job and should be replaced. Plan sponsors need to realize that when their plan provider is going to tell them how the Plan is, they're not going to say anything remotely negative that could impact their job as a plan provider. Plan providers may have a little more confidence to tell them that another plan provider is not doing a good job (such as the financial advisor complaining about the third party administrator (TPA), but that's not likely either because people worry about the consequences of speaking up against a fellow provider.

They really don't know their plan is OK until it's too late

Many 401(k) plan sponsors don't understand that despite the work of their retirement plan providers, the plan sponsor is going to be on the hook for liability unless they hire independent ERISA fiduciaries to take away the bulk of that liability. Having their plan providers telling them that their plan is in fine shape is really a false sense of security when the 401(k) plan sponsor is always going to be on the hook for liability when any issues are discovered. I will never forget the poor business that used a TPA for 25 years and didn't know that they were supposed to be provided with valuation reports because it would have come in handy when the Department of Labor mistakenly thought the owner was embezzling money. Plan sponsors can't afford just to take someone's word that the plan is OK, they need an actual presentation and evidence that they keep in case there is an error detected

The plan provider benchmarked the fees

Plan costs are an important issue and have been extremely important since the fee disclosure regulations were implemented in 2012. Plan sponsors have a fiduciary duty to pay only reasonable plan expenses and the only way they can do that is to benchmark their fees by looking at other plan providers or by using a benchmarking service. They can certainly have their retirement plan providers benchmark their fees as long as they use an impartial benchmarking service and provide the actual data to the plan sponsor. Benchmarking fees by taking the plan provider's word that their fees are reasonable, or using some biased metric, is a fool's bargain and is undermining the plan sponsor's fiduciary responsibility to only pay reasonable plan expenses. Plan sponsors need to benchmark their fees and they have to go on their own to benchmark it or hire an unbiased service like Brightscope, fi360, FRA Plan Tools, Fiduciary Benchmarks or other recognized impartial retirement plan fee benchmarking service.

The Plan is audited

Plan sponsors may claim that their 401(k) plan is in good shape because it's audited and their auditor didn't raise any red flags (which is a requirement for Form 5500 for Plans with more than 100-120 participants). That's like saying I'm healthy because I went to the dentist. A dentist only checks my mouth and there's a whole lot more to my mouth that can kill me. Retirement plan sponsors think an audit is a checkup and review of the Plan's operation and it really isn't. The purpose of a 401(k) audit is to render an opinion on the financial health of the plan to pay out benefits. During the audit, procedures are performed to ensure that the 401(k) plan is in compliance with both government regulations and requirements specified in the plan documents. It's a look at the plan, but it's a cursory look to make sure there isn't anything substantial that would stop the plan from paying out benefits that are owed to participants. Many plan errors will not be discovered on audit and many auditors don't take the reasonableness of plan fees into consideration. While a 401(k) audit is required for larger plans, it's a tool to vet the financial health of the plan, but not the overall health.

Only an independent consultant and/ or ERISA attorney can fully opine whether a plan is OK.

The fact is that most plan errors that threaten the qualification of a 401(k) plan are only discovered when there is a change of plan providers or there is an audit performed by the Internal Revenue Service or the Department of Labor. The fact is that the plan provider who caused an error isn't likely the one to discover it or disclose it. Like with benchmarking, it's advisable that a 401(k) plan sponsor hire an independent consultant or an independent ERISA attorney such as yours truly to make an independent review of the retirement plan looking at the administrative and fiduciary aspects of the plan. Only then, can a 401(k) plan sponsor really have the confidence to tell a prospective plan provider that their plan is really doing fine without hiring a full-time retirement plan administrator as an employee. For example, I charge a $750 Retirement Plan Tune-Up that is an independent review of the plan's operation that can be paid from plan assets. Rather than just relying on the word of someone who doesn't know or an ulterior motive for the plan sponsor not to know the truth, the plan sponsors can get a review on whether the plan really is OK.

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