Great 401(k) Plan Features That Aren't A Fit For Everyone

By Ary Rosenbaum, Esq.

My wife and I go to the local shopping outlet center to see what's going at Pottery Barn and Williams & Sonoma. At Williams & Sonoma, I'm amazed as to how many different kitchen items there are. While every household certainly needs utensils, plate ware, and cookware, there are gadgets to pit cherries and things you never imagined were ever created. For those types of gadgets, you have to find out what you really need so you don't go broke spending on gadgets you'll never use. The same can be said about features of retirement plan services and retirement plans that might look great on paper, but may not be the right fit for you. So this article is going to explain some wonderful retirement plan features that may not be a great fit for everybody.

Safe Harbor 401(k) Plan

A safe harbor 401(k) plan design is one of the great features that have been added to 401(k) plans in the past 20 years. It allows the plan sponsor to bypass certain compliance tests such as the actual deferral percentage (ADP) test and the Actual Contribution Percentage (ACP) Test as well as satisfying Top Heavy as long as the plan sponsor makes a fully vested contribution as set out in a safe harbor notice. I love safe harbor plans, but they aren't the right for everyone. Why? If a 401(k) plan is passing their ADP and ACP tests with ease, there really is no need to add that feature. A plan sponsor that easily passes their ADP and ACP test and satisfy Top Heavy, don't need to be tied down to the required employer contributions and notice that a safe harbor plan needs. Even if a plan fails their ADP and ACP test, a safe harbor plan may not be a right fit. Why? There are a lot of employers out there that can't afford required annual contributions. These plans who can't afford a safe harbor contribution even though they are failing ADP and ACP may have to go back to the methods to fix failed tests such as giving deferral refunds to highly compensated employees or qualified non-elective contributions to lower paid employees. So no matter how great safe harbor 401(k) plans are, it's not a fit for everyone.

New Comparability/ Cross-Tested Allocations

Just like with safe harbor 401(k), another great feature that a 401(k) plan can have is a new comparability/ cross-tested allocation. What is it? It allows a plan sponsor to offer a profit sharing contribution, but a higher percentage of compensation amounts to certain highly compensated employees. For example, if you give the rank and file employees 3% of compensation as a profit sharing contribution, you can probably give the highly compensated employees a 9% of compensation contribution. In addition, if you used the 3% non-elective safe harbor contribution, you can use the amount necessary to satisfy safe harbor to offset contributions to participants under a cross-tested design. Again, the cost is a factor for these advantageous contributions and many small to medium sized businesses just can't afford the luxury of a new comparability plan design because they don't even have the money to make contributions to the rank and file employees. A new comparability/cross-tested allocation is great, but only if the plan sponsor can afford to make it.

An ERISA §3(38) Fiduciary

Thanks to a lot of media attention and marketing, more and more plan sponsors know that they may want to hire an advisor who can serve in a fiduciary capacity such as a registered investment advisor. In order to alleviate a plan sponsor's liability and perhaps because of some great marketing, a lot of registered investment advisors and other financial institutions have been offering an ERISA §3(38) service. ERISA §3(38) is an investment manager as defined in ERISA. So while this term has been in operation since the law was effective in 1976, a lot of advisory firms have offered this fairly new service for participant-directed 401(k) plan which didn't come into existence until the 1980s. Unlike other advisors, an ERISA §3(38) fiduciary exercises discretionary control over the fiduciary process

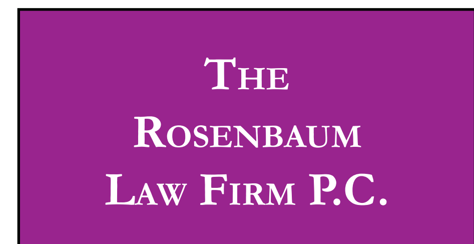
of the 401(k) plan. In English, that means that the 3(38) fiduciary makes all the decisions when it comes to investment such as developing an investment policy statement (IPS), picking and replacing plan investments, and providing education/advice to plan participants. While hiring an ERISA §3(38) fiduciary will eliminate the fiduciary responsibility of managing the financial component of the plan, it won't eliminate a plan sponsor's liability if they hired an incompetent or corrupt ERISA §3(38) fiduciary. A 3(38) is a great service but isn't for everyone. Why? In hiring an ERISA §3(38) fiduciary, a plan sponsor surrenders control of the fiduciary over to the advisor acting as a 3(38) fiduciary. There are a lot of plan sponsors that don't feel comfortable in surrendering control or have enough of a financial background that they still want input on how the plan is managed financially. In addition, 3(38) services are usually higher than normal advisory assistance, so that's a factor as well for those plan sponsors who believe they have that background to avoid that level f service. Control is a very big thing to surrender and there are plenty of plan sponsors that don't need that level of fiduciary service or don't want it.

An ERISA §3(16) administrator

With an increased emphasis on fiduciary services, third-party administrators (TPAs) and other plan provider didn't want to be left out. So they took the definition of named plan administrator under section 3(16) of ERISA and decided to offer ERISA §3(16) fiduciary services. Most plan sponsors are unaware that the TPA is a third party, so any mistakes caused by the TPA stops with the plan sponsor's buck and responsibility. So an ERISA §3(16) shifts the liability from the day-to-day plan administration form the plan sponsor to the TPA or other provider serving in an ERISA §3(16) capacity. The problem with ERISA §3(16) service is that there is a wide latitude on what providers will do. At a minimum, a 3(16) administrator will sign and file the Form 5500, as well as all distribution requests. As far as assistance in payroll and deferrals, some ERISA §3(16) will provide more relief than others. For many plan sponsors, the surrender of control and responsibility for the plan's day-to-day administration is a welcome relief. However, I know of many plans out there that don't need or want the service. Why? They have enough experienced human resources and employee benefits specialists on staff that they don't need the added expense of using an ERISA §3(16) administrator. For many small and medium-sized businesses, an ERISA §3(16) administrator is the perfect solution for those that don't want the headache or liability that goes with the day-to-day administration of the plan. For many other plans, it's an unneeded service and expense.

A multiple employer plan

A multiple employer plan (MEP) allows unrelated employers to group together in one plan with one plan sponsor. The reason for a plan sponsor to ditch their own plan and become an adopting employer to a MEP is because it will alleviate much of the liability that goes with being a plan sponsor. By being part of an association plan where all adopting employers are connected with a form of commonality, it would also eliminate the need for a 5500 for the adopting employer because only the MEP would need one. Another great reason for joining a MEP is that it's a plan cooperative in the sense that smaller plans are being brought together to get better pricing because a MEP would have more assets together than plans that are separate and small. Why would a plan sponsor not join the MEP? A plan sponsor that isn't interested in a MEP tends to have enough plan assets where they get better pricing or they just want to be on their own because they want a sense of control over the retirement assets of their employees. President Trump recently issued an Executive Order that may pave the way for Open MEPs, which are plans where the employers have no commonality to become single plans for Form 5500 purposes again, plan sponsors will likely hear more about MEPs. However, as stated, it's not the right fit for everyone.



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The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw