A Plan Sponsor's Foolproof Way To Getting In Trouble

By Ary Rosenbaum, Esq.

The foolproof method to getting investigated for tax evasion? Stop filing your taxes. The foolproof method to get hit by a car? Run into mid-town traffic. The foolproof method to get the chicken pox? Don't take the vaccine and hang out with infected children. Whatever the problem is, there is a certain foolproof method to get that problem. The same can be said about a retirement plan and the employer that sponsors it. There is a sure foolproof method for a retirement plan sponsor to get their plan and themselves in trouble, this article will let you know what that method is.

Not hiring a third party administrator (TPA) or hiring an incompetent one

A retirement plan is an intricate entity. It requires an annual Form 5500 filing, as well as extensive discrimination testing. Unless a plan sponsor is a TPA, there is absolutely no way that a retirement plan sponsor can handle the daily and/or annual administration of their retirement plan on their own. That is why they have to hire a TPA to delegate the job of performing the compliance testing, keeping the records together, and filing the annual Form 5500. Not only is important that a plan sponsor have a TPA to do the grunt work of plan administration, but that they find a competent TPA. There are many good TPAs out there and there are some that are just not so good. Incompetent plan providers can threaten the tax qualification of a retirement plan because they perform their duties incorrectly and continued tax qualification requires correct compliance. If a plan sponsor hired an incompetent TPA, it is a certain foolproof way to get the plan in trouble. Not only do incompetent TPAs do bad work, they also get the plan sponsor in harm's way because it was the plan sponsor's fiduciary duty to hire competent plan providers. Not hiring a TPA or hiring an incompetent TPA is a recipe for a disaster.

Not filing the Form 5500 on time

Every qualified retirement plan with a non-owner employee must file an annual tax return called Form 5500. When the 5500 is filed for the very first time, it is basically an alert to the Internal Revenue Service (IRS) and the Department of Labor (DOL) that a retirement plan exists and that they should expect an annual return until there is a return filed one day as the final tax return for a terminating plan. If a plan sponsor fails to file a return or fails to file one on-time, the IRS and/or DOL will eventually contact the plan sponsor an assess a very large penalty. Depending on how many returns and how late the returns are, penalties can be in the tens of thousands of dollars. The penalties for missing and/or late Forms 5500 can be corrected with lower penalties under the DOL Voluntary Fiduciary Correction Program. Ignoring the problem of missing and late tax returns could cost tens of thousands of dollars in penalties and there is no statute of limitations for years where the Form 5500 was not filed. So missing and late Form 5500s are a foolproof method in assessing huge penalties and threatening the tax qualification of the retirement plan.

Not using a financial advisor

Home Depot and Lowes lets us think that we can do home projects by ourselves and a lot of time, they are right. Even some of the discount brokerage and mutual fund companies can convince us that we can invest on our own. But when it comes to picking investments for a retirement plan with employee money in it, we are way out of our league. If a retirement plan contains at least one non-owner employees, it is important to hire a financial advisor. Not hiring a financial advisor is a foolproof method to getting in trouble. A financial advisor will not only assist in picking investments, a good financial advisor will also help plan participants manage their investments in the Plan (if they are directing their own account) by offering them investment education and/or investment advice. A financial advisor is not just about picking investments, it's about putting a process in place that will help a plan sponsor limit their liability. Using a financial advisor isn't about picking investments that are the top of the charts in terms of return, it's about helping the plan sponsor in managing the fiduciary process and helping educate plan participants because educated plan participants will do better with the investments they picked than those without education. A plan sponsor that has no background in financial advisory work needs help in managing the fiduciary process. Whether the financial advisor is a broker, registered investment advisor, or an advisor offering ERISA fiduciary services such as §3(38) isn't as important as just

finding one. Only a fool knows everything; a wise plan sponsor will select a financial advisor to assist.

Not reviewing fee disclosures

A plan sponsor has a fiduciary duty to determine whether thee fees that the plan pays is reasonable or not. With fee disclosure regulations promulgated in 2012, plan sponsors now get a somewhat clear description of the fees being charged and if the plan is self directed, the plan participants get disclosures as well. The problem is that too many plan sponsor shirk their responsibilities or don't know their responsibilities as a plan sponsor and just put those disclosures in the "back of the drawer" upon receipt. Plan sponsors can't simply make those disclosures disappear, they need to actually review them and determine whether the fees that are being charged against the plan are reasonable or not. That means seeing what other providers are charging or using benchmarking reports to determine whether the fees being charged are reasonable or not. That does not mean getting the cheapest provider, but getting a reasonable provider. Not reviewing fee disclosures is just a foolproof way for a plan sponsor to get into trouble.

Not getting an ERISA bond and/or not getting fiduciary liability insurance

There are two types of insurance to minimize the liability of being a plan sponsor, one is mandatory and the other is not. An ERISA bond is a requirement for all ERISA plans; it is used to insure plan assets against theft by a plan fiduciary. If a plan does not have an ERISA bond, it is supposed to answer as much on the Form 5500 and that is a trigger/ red flag for the DOL to audit the plan. Fiduciary liability insurance is not mandatory; it protects the plan sponsor and individual trustees in case of litigation concerning the Plan. From first hand experience, a fiduciary liability insurance policy should be purchased because litigation costs (even if the plan sponsor is in the right) are expensive. Not getting an ERISA bond and/ or fiduciary liability insurance is just plain silly because the costs are nominal, but the protection against pecuniary harm is not. A plan sponsor who doesn't get an ERISA bond and/or fiduciary liability insurance is just asking for trouble and financial harm.

Not reviewing the plan's compliance and contribution formula

Every retirement plan with non-owner employees must go through compliance testing. Tests that fail compliance testing need correction action, either through more contributions or refunds to highly compensated employees. A review of the plan's contribution formula is necessary to make sure that there are no corrective formulas that could avoid fail testing later. I can always recall the plan sponsor that was able to add a safe harbor contribution formula that they could afford to avoid returning 90% of the owner's salary deferrals back to her. A plan sponsor's needs and wallet changes over time. So when the employee force grows or shrinks, there maybe a need to look at the compliance tests and contribution formula. Otherwise, the plans sponsor maybeleaving money on the table for themselves and the participants in the plan.

Self-dealing

The assets of the retirement plan are for the exclusive needs of the plan participants. So a retirement plan isn't for the use of the plan sponsor to enrich itself. That means the assets of the Plan can't be used to benefit the plan sponsor or any other plan fiduciary. It also means that the selection of plan providers should not be based on nepotism or doing "favors" to get favors back. I remember years ago being contacted by a plan sponsor who indicated he was being investigated by the DOL. He admitted he used plan assets for personal use. I advise him to cooperate and he thought otherwise, he knew best. He ended up serving 3 years in prison. While it should be basic knowledge that stealing from a plan isn't right, you'll be surprised how many plans still do that. A plan sponsor using a retirement plan for their own gain is a certain foolproof method to landing in trouble.

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