The Road To Hell Is Paved With Good Intentions For 401(k) Plan Sponsors

By Ary Rosenbaum, Esq.

Sponsoring a 401(k) plan is one of the best things you can do for your employees as employers. Next to health insurance, it's probably the best thing you can provide to your employees as a benefit. The problem with sponsoring a 401(k) plan is the problems that can be associated with it. Sponsoring a 401(k) plan and not managing it correctly, reminds of the adage that the road to hell is paved with good intentions. While you may have good intentions by sponsoring a 401(k) plan, keeping your eye off of the plan and not understanding your duty in managing the plan will lead you down the road to ruin. This article is a sobering look at fiduciary responsibility that you might not have known before.

The great power of being a fiduciary

One of the best parts of the latest Spiderman reboot with Tom Holland is that I didn't have to see Uncle Ben died a third time after telling Peter Parker that "with great power comes great responsibility." While I didn't want to see another version of Uncle Ben die, I still think that his motto that Peter Parker takes to heart as Spiderman also fits the role of a plan sponsor. Being a 401(k)-plan sponsor means you wear three hats: you're an employer, you're a plan sponsor, and you're a plan fiduciary. Being an employer and plan sponsor are important roles, but being a plan fiduciary comes with the greatest responsibility since it comes with the greatest power. A fiduciary is a person who holds a legal or ethical relationship of trust with one or more other parties. As a plan sponsor, you're also a fiduciary with a duty of care to plan participants by holding their retirement assets in the plan's trust. You have the highest duty of care in law and equity as a fiduciary. As a plan fiduciary, you need to prudently take care of the assets belonging to plan participants. So you have to treat participants' assets with a higher duty of care than you would with your own money. The scary part of being a fiduciary is that in many circumstances, any breach of fiduciary duty may involve your liability. That is why that in addition to the legally required ERISA bond to protect plan assets from theft by a fiduciary, you should also purchase fiduciary liability insurance to get you liability protection in case you ever get accused of breaching your fiduciary duty. The other thing you have to realize is that you can always minimize your fiduciary liability, but you can never fully eliminate it. So no matter what "elixir", "magic bean", or another service that a plan provider sells you, there is always going to be some liability that goes with whatever service you hire.

Liability coming from your plan providers

As discussed, you're always on the hook or liability in your role as a plan fiduciary. If you hire a third-party administrator (TPA) and they make an error, you still have to fix it as a plan fiduciary. Sure, you can sue them or try to collect through their insurance policy, but you're still going to be on the hook to correct the problem as soon as possible. If your plan is under audit for errors or perceived malfeasance and it's the fault of the TPA or another provider, I assure you that blaming them won't get you very far in the eyes of the government auditor. I've seen plan sponsors being sued for millions, just because of the errors committed by plan providers. Sure a plan provider might ultimately be culpable for what they have done to you, but it's little solace after outlaying the cost of fixing the error immediately to preserve the tax qualification of your plan. Even if you have a plan provider serving in a co-fiduciary or full fiduciary capacity, there is still liability exposure to you. There are a lot of solid ERISA §3(16) administrators and §3(38)

advisors out there that will assume the fiduciary function of your plan in the day to day administration or the fiduciary financial process, but that doesn't mean you're off the hook for the mistakes they make. While these ERISA fiduciaries will assume the liability of the portions of this plan, you're still on the hook for hiring them. There is an ERISA §3(16) administrator/TPA that was arrested for stealing millions from his clients. While from his vantage point, he assumed the liability from plan sponsors in day to day administrators, these plan sponsors are still on the hook for any theft of plan assets if the coverage of the ERISA bond has been exhausted. Too often like a Bond movie villain trying to kill James Bond, plan sponsors hire a plan provider and assume everything goes to plan. Like my grandmother would always say, nothing in life goes to plan. That is why it's always important to have your plan providers reviewed to make sure they're doing the job that they claimed to do. Too often, plan errors are only discovered during a change to a new provider (such as the replacement of the TPA) or under government audit. The bill of correcting plan errors, years after the errors are made are far larger than they would have been if corrected right after the error was made.

Fees, fees, and fees

There was a unique dilemma from 401(k) plan sponsors before the implementation of fee disclosure regulations in July 2012. The dilemma was that as a plan sponsor, you have a fiduciary duty to pay only reasonable plan expenses and before July 2012, your plan provider didn't have to tell you how much directly and indirectly they received in fees from your plan. So while you were supposed to know how much the plan was being charged in plan expenses, you had to recourse to compel your plan providers to tell you the whole truth on fees. Now with fee disclosures, you don't have that excuse anymore. Your plan providers tell you how much they receive in direct and indirect fees from your plan and it's your job to determine whether those fees are reasonable for the services provided. Too many plan sponsors put that fee disclosure in the back of the drawer and do nothing with it. As a plan sponsor, you need to determine whether the fees being charged to your plan are reasonable or not. So you have to go out and benchmark your fees against what other providers charge by contacting the competition or using a benchmarking service. Keep in mind, fees are all about reasonableness for the service provided. You don't have to pick the cheapest provider, the correct measuring stick is reasonableness.

The limitation of participant-directed plans

When providers talk about 401(k) plans where participant-directed investments, they talk about a plan sponsor's limited liability for a participant's losses from their investment. The problem is that they are giving a broad interpretation of the law that governs it, which is ERISA §404(c). ERISA §404(c) isn't a blanket form of immunity or liability protection. If you don't manage a prudent fiduciary process of selecting and replacing plan investments, you will get very little protection in liability. If you don't provide participants with enough information to make informed investment decisions, you're also going to get little protection from liability. That is why to avoid the road to hell, you need to have financial advisors in place that can help manage the fiduciary financial process of the plan to limit your liability.

Former and missing participants

A unique provision of a 401(k) plan that is come under recent scrutiny is the involuntary cash-out rule. Whether the plan has the $1,000 or $5,000 limit, all it means is that former participants must provide consent for distribution from their account if their balance is greater than that limit. This is a problem whether you can find the participant or if they're missing. Having former participants in your plan is a liability trap because former participants have the same right as current participants in terms of notices and disclosures. Of course, if these participants are missing, you have no way of providing the information required by ERISA. That is why it's important to have a process in place to contact former participants to take their money as well as a process if you can't find these former participants. The fact that the Department of Labor is now focusing on this problem is reason enough why you need to as a 401(k) plan sponsor.

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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