The Costs For Being Cheap As A 401(k) Plan Sponsor

By Ary Rosenbaum, Esq.

There is nothing wrong with being thrifty. You should never pay the full price for something that you can get at a discount. Being thrifty is different from being cheap. Being cheap is about not wanting to pay for something just because you don't want to pay for it. I think cheapness is one of my least favorite traits in people, next to dishonesty and narcissism. When it comes to sponsoring a retirement plan, plan sponsors have a duty to pay only reasonable plan expenses, which means they have to be thrifty. Paying reasonable plan expenses isn't about paying as little as possible, so it means that plan sponsors don't need to be cheap. Quite honestly, they can't afford to be cheap because being cheap can cost a plan sponsor a lot more in the long run.

Hiring a provider just because they are cheap

Many years ago, my wife and I would shop weekly at Wal-Mart. We thought we were getting a good value especially when it came to buying household gadgets and tools. The problem was that these gadgets would break easily and the household items we'd buy at Pottery Barn, and Williams & Sonoma would be more durable and a better value despite their increased cost. So there was a higher cost for buying cheaper products because we ended up having to replace the cheaper items that broke with a more durable and expensive kitchen tool anyway. Plan sponsors do the same thing when they hire plan providers solely on cost. Plan Sponsors have no requirement to hire the cheapest plan provider; they just have to make sure that they pay reasonable plan expenses for the services provided. So a plan sponsor has the flexibility to pay more for plan services if they are getting more in the actual level of service. So a plan sponsor can certainly hire the cheapest plan provider as long as they are getting the services they needed. Some cheap plan providers are so no-frills, they are like the car manufacturer who would sell you a car without a steering wheel. Plan sponsors need to understand the value of hiring competent plan providers because many low-cost plan providers may be cutting corners in order to meet their low price There are so many horror stories about some of these low cost/low service providers that cause headaches for plan sponsors because they are not doing a big part of the job by not shielding plan sponsors from potential liability. I will always remember the third-party administrator (TPA) who created much grief and litigation for their plan sponsor client by failing to complete 25 years of valuation reports that would have shown that the plan sponsor wasn't embezzling the plan assets. It should be noted that there are quite a few good low-cost plan providers who offer a competent service, so a plan sponsor needs to find another reason to hire a low-cost plan provider other just than cost. Just picking a provider based on their cost is almost as silly as picking one by pulling a name out of a hat.

Going it alone without a financial advisor

What a plan sponsor does with their own private money is different from the way they should act with the retirement money of their participants. Being a plan sponsor means being a plan fiduciary, so they have a higher duty of care with participants' money than their own money. So that means while a plan sponsor can certainly have the capacity to invest their own money without guidance, it can't when it comes to the retirement plan they offer to their employees. Sure anyone with some sort of financial background can do a decent job of selecting investment options for their portfolio, but they miss the point of why a retirement plan needs the guidance of a financial advisor. A retirement plan doesn't need a financial advisor just for the selection of plan investments; a financial advisor does so much more. A good financial advisor is in the business of protecting plan sponsors by helping them try to minimize their liability. For plans where the trustees direct the investments, advisors help the

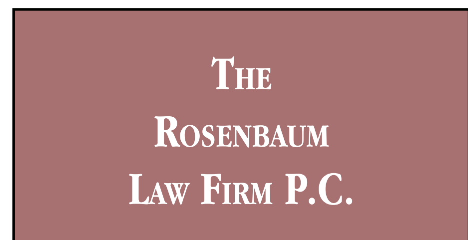
plan sponsor select plan investments based on set criteria set forth in an investment policy statement (IPS). With plans where the plan participants direct the investments, there is a need for more vigilance. Too many plan sponsors assume that when plan participants direct their own investments, the plan sponsor is protected from liability under ERISA §404(c) from losses incurred by participants. The problem is that ERISA §404(c) only offers a sliding scale of protection based on what plan sponsors provide plan participants. The plan sponsor needs to provide enough information for plan participants to make informed investment decisions. So liability protection is offered almost in proportion to what information plan sponsors give their employees. That means that the investments offered under the Plan must be vetted and reviewed on a continuous basis and the plan participants must get enough investment education to make informed decisions. Investment education is about teaching the basics of investments and it doesn't just mean handing out Morningstar profiles. Investment education is different from investment advice; advice is specific advice to plan participants on which investments to pick while education is all about teaching general basics of investments. While a plan sponsor can certainly invest on their own without the use of a financial advisor, they need to use one for their retirement plan.

Not fixing plan errors through voluntary compliance

The administration of a retirement plan requires a level of high sophistication. That's why most plan sponsors delegate the day-to-day administration to a TPA. Even with the most competent TPAs out there, mistakes do happen. Any type of plan error needs to be corrected because every retirement plan needs to comply with the Internal Revenue Code and any plan that has at least one employee covered under their plan must also be compliant with ERISA. Errors must always be corrected. Some small errors can be self-corrected without seeking approval from the Internal Revenue Service (IRS). Other larger errors based on the number of years and/or the size of the error must be submitted to the voluntary compliance program of the IRS. Errors that involve the violation of ERISA must be submitted through the Department of Labor's Voluntary Fiduciary Compliance Program and there is a delinquent filing voluntary compliance program for plan sponsors to submit missing Form 5500s. When I usually get called by a plan sponsor about a plan error and the costs involved in fixing them, I usually get asked what would happen if they just ignore the error. Ignoring the problem of a plan error is a retirement plan sponsor version of Russian roulette. Plan errors that aren't corrected, but are discovered by an IRS agent on a plan audit will have some severe consequences. The voluntary compliance program will have set compliance fees, which serve as the pecuniary penalty. Penalties for errors discovered on a plan audit don't get such low, set rates. Penalties for plan errors can vary and discovery of plan errors may entice the IRS auditor to review other plan years which may lead to other plan errors and further penalties. Voluntary compliance programs are a forgiving feature by the government to invite plan sponsors to correct serious plan errors at a low compliance fee. The reason that the IRS and Department of Labor send auditors in the field is to make sure plans comply with the law and plans that don't will be punished accordingly. So it makes no sense for plan sponsors to try to save a couple of dollars by foregoing submission to a voluntary compliance program and gambling that they won't be audited within the next 3 years (which is the statute of limitations for each plan year). From experience, it's not worth the gamble when penalties and headaches are larger when a plan gets audited.

Not being proactive because it costs money

Too many plan sponsors are reactive rather than proactive and one of the many reasons that plan sponsors aren't proactive is because it costs money. Plan sponsors don't understand that any errors in plan administration aren't discovered until there is an IRS audit or when there is a change in TPA. One way they can avoid the cost and headache of correcting a plan error is to actually have the plan reviewed by an independent retirement plan consultant or ERISA attorney. For example, I've offered a plan review called The Retirement Plan Tune-Up for $750 which is a top to bottom review of the plan and its administration. While it's a cost-effective review that can be paid from plan assets, I can probably count on two hands how many reviews I've completed in the last 10 years because plan sponsors just don't want to spend money. Maintaining a retirement plan costs money and there is a higher cost of being reactive than by being proactive.



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