When You Have To Tailor Your 401(k) Plan

By Ary Rosenbaum, Esq.

When it comes to clothes, you can buy a suit or a dress off the rack to wear or you can tailor a suit or dress to fit you. Having tailored clothing allows the clothing to perfectly fit your shape because our shapes are different. When it comes to 401(k) plans, most plan sponsors forget to realize that a 401(k) plan should be perfectly tailored to fit your needs and those needs change from time to time especially from the time when you set up the plan initially. This article is all about how you need to make sure that the 401(k) plan is tailored to your needs as a plan sponsor and employer.

Your plan isn't written in stone

Too many plan sponsors have a set and forget attitude for their retirement plan. They create the plan and never think about it again, except for the administrative functions of being a plan sponsor. Your 401(k) plan is governed by a plan document, which is legally binding. The plan document like the Constitution is a living and breathing document. The parameters that are outlined in your plan document isn't written in stone. Like the constitution, the plan document can be amended when needed. Situations and priorities may change and your plan document should reflect that change. You should hire competent plan providers that are pro-active and can help advise you about when your plan document should be amended to reflect the changes in your situations.

Never lose sight of what it was for

It's important as a 401(k) plan sponsor that you never lose sight of why you put the plan in place in the first place. The 401(k) plan is a tool, it's a tool to recruit and/or retain employees. It's no different than health insurance, fringe benefits, reimbursements, discounts, or other employee benefits.

Demographics of your business changes

When you set up your 401(k) plan, it could have been set close to when the business was created. The 401(k) plan could have been created at a time when your employee demographics were quite different. Your 401(k) plan is like fashion, it needs to change with the times. If your employee base grows, contracts, or is substantially different from the last time the 401(k) plan was changed, you need to check if the plan still fits your needs. What worked well for your plan when there were six employees may no longer make sense when you have a dozen. If your employee base is consistent in employment length or has a high turnaround, eligibility may be something to look at. If your business is more successful, you may want to revisit your benefit formula structure to determine whether plan design should be changed to allow for greater contributions to your highly compensated employees and providing a minimum benefit to lower-paid employees. When your situation changes in your business in any way, you must start looking at your plan provision and see if they still fit your needs.

Business isn't good

The COVID pandemic has negatively impacted so many businesses around the country. While so many businesses have closed down their doors, others have had to come back on their benefits. That is a problem when so many plan sponsors had required contributions under a safe harbor plan design or a stated matching contribution. Also, plan sponsors that shed 20% or more of their plan participants through termination of employment may have a partial termination that would require 100% vesting of all. contributions for those terminated. Whether your businesses contracting because of COVID or

not, it is time to take a look at your plan.

If you're failing discrimination testing

Your 401(k) plan is a qualified retirement plan, allowing for your employer contributions to the plan tax-deductible and earning tax-deferred treatment for your employees' retirement savings in the plan. By having a qualified plan, you agree to abide by the terms of the Internal Revenue Code (the Code). One of the requirements set forth by the Code is that the plan can't discriminate in favor of highly compensated employees. Another is that benefits under the plan can't be more than 60 percent held by key employees. If you fail any of the tests or are deemed to be Top Heavy, there may be refunds to highly compensated employees and/or required contributions made by you to your employees. If you're failing your testing or coming close, that should be a time for you to review your plan with your plan providers to determine what needs to be done to avoid a similar fate in future plan years. That might require a safe harbor contribution or limits on benefits for highly compensated employees or adding an automatic enrollment feature. Whatever the choice is, something needs to be done to your plan and you need plan providers that are pro-active in telling you that this discrimination testing issue is a problem.

Making sure your plan providers are still effective

When I was a kid, I had a great pediatrician. However, when I was in my 20s, it was time to see someone else because I outgrew Dr. Apfel. When your plan grows in size, you need to make sure that your plan providers are still effective and can still handle a plan of yours that is growing in size. A plan provider who might be great in the micro 401(k) plan market may be a terrible fit when the plan has assets of $5 million or more. There is no plan provider out there with the competence = to handle every type of 401(k) plan. Some plan providers are great at plans that are safe harbor and don't have any discrimination testing, but terrible when they have to perform compliance testing. There are plan providers who have no experience in intricate plan design, such as new comparability or in conjunction with a cash balance plan. You need to make sure that your plan provider is the right fit for you. It's important to be loyal to a spouse or a sports team or an alma mater, you have no room to be loyal to a plan provider especially when that loyalty is blind. As a plan fiduciary, you have to put the needs of the participants before your loyalty to any plan provider and you need to cut them loose when they no longer fit the needs of the plan.

Make sure your plan is still cost-effective

I've been in the retirement plan business for 22 years and for most of that time, plan sponsors didn't fully know how much they were paying in plan expenses. It defied logic, but there was no requirement for plan providers to fully disclose the fees they would charge directly to a 401(k) plan. That was a problem as a plan sponsor had the fiduciary duty to only pay reasonable plan expenses. Thankfully, the Department of Labor ended that by creating fee transparency through fee disclosure requirements. Since 2012, plan sponsors like you can understand how much your plan is paying in fees. The problem is that too many plan sponsors ignore the fee disclosure statements and throw it in the garbage. When you get those fee disclosure statements from your plan providers, you have to determine whether the fees being charged are reasonable for the services provided. You don't have to find the cheapest provider, you have to make sure the fees are reasonable for the services provided. You can always pay more in fees if you get more in services. The only way to determine whether fees are reasonable for the services provided is by seeking out price quotations from other plan providers or to benchmark their fees by using a service. Sometimes your plan provider may no longer be cost-effective when the assets in your plan grow as some plan providers are more cost-effective in servicing smaller plans. You also need to make sure that the investments in your plan are the proper share classes for a plan of your size. There have been so many 401(k) plans sued (usually larger ones) because the plan was using more expensive retail share classes of a mutual fund when a cheaper version of the same fund (an institutional class) was available. The only way you can determine whether your plan is using the proper class is by asking your financial advisor. If your financial advisor has no idea, that's a perfect clue that it's time to replace your financial advisor.

THE ROSENBAUM LAW FIRM P.C.

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