Things That 401(k) Plan Sponsors Forget To Do, But Need To Do

By Ary Rosenbaum, Esq.

People procrastinate. I know, as a procrastinator. I think I might have been the last person on Earth to finally get a high-definition television. But when things are important and I have an incentive to not waste time, I'll do it. I took three different state bar exams and never studied the day before. 401(k) plan sponsors are known to procrastinate because they are reactive, rather than proactive. This article is all about what plan sponsors should be doing already instead of just doing it at the last second.

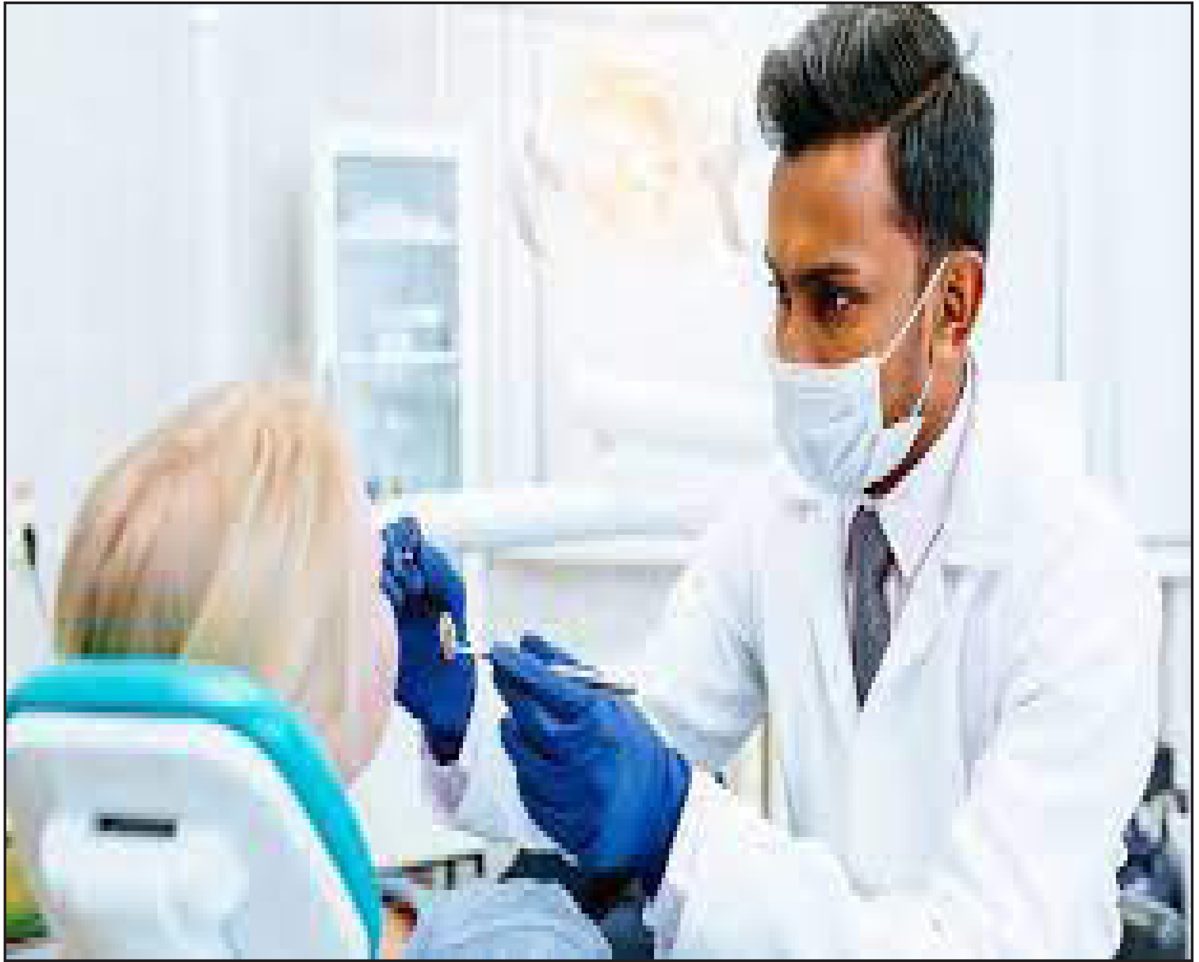
Reviewing plan providers for price and competence

I had an amazing dentist, the problem is that she was an out-of-network provider for every insurance I ever had. It got costly when you have one child who eats as they live with Willy Wonka. I hated the idea of changing dentists, but I wanted one in the network. The problem was the new in-network dentist covers all the basics, but spends a lot of time, pushing needless procedures that insurance will only cover 10%. You don't know what you have until you see another provider. As someone who works with small and medium-sized retirement plan sponsors, I notice that very few bother to review the effectiveness and cost of their retirement plan providers. I had one plan sponsor recently ask me to review their current third-party administrator (TPA) for cost and that's another thing that most plan sponsors don't do. As a 401(k) plan sponsor, you have a fiduciary duty to hire effective plan providers and pay reasonable expenses for the services provided. So often, 401(k) plan sponsors will take the word of their plan providers that their plan providers are doing a good job and get the shock (usually on an Internal Revenue Service or Department of Labor audit) that they're not and may have to take a checkbook out to pay for penalties or corrective contributions. A 401(k) plan has to review its plan providers for competence, but price too, While a plan sponsor has to make sure that plan expenses are reasonable, they don't have to pick the cheapest provider. Changing a good provider to save a few pennies isn't wise because change takes time and. effort and you may not even be happy with the new provider. Thanks to fee disclosure regulations, you know how much your providers are making, You should never throw those fee disclosures away like junk mail, it's a clue you need to use them to benchmark your fees.

Adding Roth 401(k) contributions

In 1997, the Internal Revenue Code added Roth IRA accounts which created an account that allowed participants to accumulate after-tax IRA contributions and have them grow tax-free. In 2001, the Internal Revenue Code was amended to allow for Roth 401(k) contributions, starting in 2006. This feature allowed participants to defer their 401(k) contributions for some or all contributions on an after-tax basis. By paying the taxes upfront on their salary deferrals, participants would be able to accumulate tax-free earnings on those contributions. Offering participants to defer some or all of their salary deferral contributions on a Roth basis doesn't change your compliance testing, and is merely an issue for payroll and the 401(k) plan's recordkeeping. Most 401(k) plan sponsors very slowly added this feature to their 401(k) plans because most participants couldn't afford to forego the tax deduction of regular 401(k) deferrals. Slowly, but surely, more and more plans have added the feature to their plans. Thanks to the SECURE 2.0 retirement plan law signed at the end of 2022, employer contributions can now be made on an after-tax basis if you want to allow it. That means, your employees have the option to pay the up-front taxes on employer contributions and enjoy tax-free growth.

Another change by SECURE 2.0 is that required minimum distributions will no longer be required from Roth 401(k) accounts starting in 2024 for participants who retire or are 5% percent owners who attain age 72 while still working. The biggest reason you have to add a Roth 401(k) feature is a requirement for highly compensated employees and their catch-up contributions after attaining age 50. Starting in 2024, any plan participant who is a Highly Compensated Employee that is a 5% owner or is making over $145,000 will have to "Roth-ify" their catch-up contributions, and pay taxes on it in the year they contribute, instead of deferring the income on these contributions. So if you are one of the few plans that don't offer Roth 401(k) contributions, you really should since major changes are around the corner in 2024.



Having a formal 401(k) committee and actually using it

I'm torn about committees because, in the outside world, I don't see them working. I wanted to get involved in the alumni organization for my college newspaper. They placed me on the fundraising committee where we had one meeting and two journalists were trying to lecture me on unrelated business income for non-profit organizations, which I have personally worked on as an attorney. 401(k) plans need a committee to run them, there has to be a process in place that shows prudent fiduciary decisions. The process also has to be followed. Creating a committee that isn't functional like the alumni fundraising committee of the Stony Brook Statesman can be considered a fiduciary breach by a 401(k) plan sponsor. You need an actual committee that meets and makes the decisions in running the plan, implementing investment decisions with the help of the financial advisor, benchmarking fees, and hiring and firing plan providers. Minutes need to be kept, as well as the backup as to why the committee made the decisions that it did.

Holding enrollment/education meetings

Speaking again of dentists, many 401(k) plan sponsors treat participant enrollment/education meetings like dental appointments, by trying to avoid them. The problem is that 401(k) plan sponsors can't do that. Under ERISA §404(c), plan sponsors are limited from liability if participants make their own investment decisions. The problem is that plan sponsors can only avoid liability if they provide enough information to participants to make informed investment decisions. A former employer of mine had a 401(k)plan where they didn't have enrollment meetings, hadn't changed funds in 10 years, and didn't have a financial advisor working on the plan. Under the rules concerning participation direction, they would get zero liability protection. So ignoring your financial advisor's plea for an enrollment meeting for new participants and an investment education meeting for all participants is a bad idea. Thanks to SECURE 2.0, you will have the opportunity to provide de minimis benefits such as gift cards to get your employees more involved in your 401(k) plan. Getting people involved in your 401(k) plan is a good thing because they are saving for retirement and it is an excellent tool to recruit and retain employees. A 401(k) plan that has a lack of participation is a sign of a bad plan and a bad employer.

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