Substitutions That 401(k) Plan Sponsors Can't Afford To Make

By Ary Rosenbaum, Esq.

I was a kid who grew up in the 1970s and 1980s where people started to become a little more health-conscious by offering substitutes for well-known foods. There was this whole push to replace butter with margarine and there was certainly a difference in taste and I don't know anyone who eats margarine today (other than for baking). There was a push with diet soda that had saccharin and later, Nutrasweet, as a healthier alternative to sugar. People swore up and down that saccharin caused cancer in laboratory animals and that Nutrasweet caused brain tumors, both of which have not been substantiated. 401(k) plan sponsors think they can substitute a part of their job with something else and as plan fiduciaries, they do so at their financial peril. This article is all about substitutions that as plan sponsors, you can't afford to make.

Substituting their role as plan administrator with the TPA

The third-party administrator (TPA) you hire is a third-party administrator. They aren't the plan administrator. Unless you hire someone who will serve as an ERISA §3(16) administrator, you are the plan administrator. Being the plan administrator means that you are on the hook for liability for errors and transgressions that go with the day-to-day administration of your 401(k) plan. You can't afford to have a set it and forget mentality when it comes to the day-to-day administration of your Plan. The use of a TPA is no substitute for your role as plan administrator. The job of the TPA is to assist you in the day-to-day management of the plan, but their screw-ups belong to you. If the compliance testing is incorrect or the Form 5500 wasn't filed, the costs of these errors belong to you. Sure, you can always sue the TPA for errors or seek some sort of reparations, but that doesn't change you being on the hook for liability. I have fixed the errors made by TPAs, some that are nearly catastrophic, and many times, the plan sponsor will bemoan their fate and that they felt betrayed by their TPA. The TPA isn't your spouse, mistakes happen. The only problem is that you will foot the bill for the mistakes that your TPA makes. You can certainly hire an ERISA §3(16) administrator that will replace you as plan administrator. That means that the bill for fixing errors belong to them because of their role as plan administrator. The only problem with hiring an ERISA §3(16) administrator is that you have to review their contract to see what parts of the job of plan administrator they will assume and what they won't. There is a wide degree of responsibilities that different ERISA §3(16) administrators may assume, so it's important to have an ERISA attorney (cough, cough) review your contract with such a provider to make sure enough of your liability is limited.

Plan highlights are not a Summary Plan Description

Retirement plans are covered by both the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA). The Internal Revenue Code is concerned over tax qualification of a qualified plan and ERISA is interested in protecting participant rights. ERISA requires you to give to your participants and beneficiaries (if the participant is deceased) a Summary Plan Description (SPD). An SPD describes their rights, benefits, and responsibilities under the plan in an understandable language. It's a summary of the plan document. The SPD includes such information as the name and type of plan; the plan's eligibility requirements; description of benefits under the Plan and when participants have a right to those benefits; a statement if the plan is maintained under a collective bargaining agreement; the different contributions to the plan and the methods used to calculate the amount of contribution; provisions governing termination of the plan; procedures regarding claims for benefits and remedies for disputing denied claims; and a statement of rights available to plan participants under ERISA. Employees must receive a copy of their plan sponsor's latest SPD within 90 days after becoming a participant under the plan. The SPD is the SPD, it is not a plan highlights that are handed out to plan participants during an enrollment/investment education meeting. Plan highlights is a two-page document,

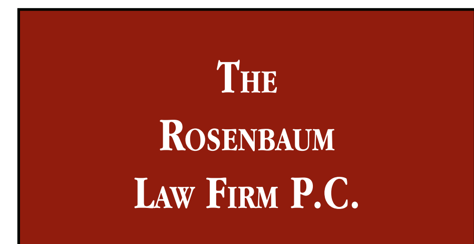
that is an executive summary of the plan's features. An SPD is a 25-40 page document that is required by ERISA to be handed out to participants, a plan highlight is not required. A plan highlight is a very short Cliff Notes version of the SPD, it is no legally accepted substitute. Not only must an SPD be handed out when an employee becomes a participant in the Plan, but a new SPD must also be handed out when you amend and restate your plan document. Also, if your plan document has a provision amended, a revision notice to your SPD must be provided called a Summary of Material Modification (SMM). Keep in mind that failing to furnish an SPD may result in a financial penalty leveled by the DOL. In 2021, the penalty is up to $159 per day not to exceed $1,594 per request (it will be adjusted for inflation annually). Forgetting to give participants a copy of the SPD sounds dumb, but plan sponsors do it all the time because they don't know that it's necessary to disseminate it and they have plan providers that don't make sure that it's distributed. You need to understand that an SPD needs to be distributed when participants become eligible and when the plan document is restated, as well as providing SMMs when an amendment to the plan is made.

Morningstar profiles aren't investment education

I always tell the story of how my old law firm's plan was a hot mess and the human resources director responsible for the hot mess, asked for my opinions on how to fix the plan, and then simply ignored my suggestions. I keep on bringing up the story of Pat because she was mismanaging the plan for 10 years, took a couple of suggestions from me, and ignored the rest. I used Pat as an example of plan sponsors who don't know what they're doing and also the fact that I was so embarrassed that my important advice was being ignored by someone who caused the plan so much potential harm over the years. The 401(k) plan was mismanaged even though we had ERISA attorneys on staff and one of the major problems was that Pat, upon enrollment of new participants in the plan, would just hand out Morningstar profiles to plan participants, who elected their investments in the Plan. One of the biggest misconceptions about participant-directed 401(k) plans is the incorrect view that plan sponsors are not responsible for the losses of investments made by participants under the Plan. Participant-directed plans offer limited liability to 401(k) plan sponsors under ERISA §404(c), which governs participant direction of investment under ERISA covered plans. Plan sponsors can only limit their liability under ERISA §404(c) by providing enough information to participants so that they can make informed investment decisions. Handing out Morningstar profiles isn't enough information, it's not a substitution for providing participants with investment education or investment advice. Protection under ERISA §404(c) also requires a prudent process of selecting and replacing investment options based on some sort of criteria. It didn't help our plan that Pat, as a plan trustee, didn't review the investment options under the plan for the past decade either, which brought up another problem, as discussed below.

Handling investments instead of using an advisor is a bad idea

After looking at the enrollment form that Pat gave me at the law firm, I looked at the fund lineup and it looked like a great selection of funds from 10 years earlier. I asked Pat who selected these funds and she advised me that it was a former ERISA partner that selected the fund lineup, 10 years earlier. The 401(k) plan had no financial advisor on the plan and you will be surprised how many ERISA covered 401(k) plans that don't have a financial advisor. Everyone thinks a financial advisor selects investments and that they can handle the fund selection on their own, especially if they select index funds. Selecting funds is just a small part of what a financial advisor does in servicing a 401(k) plan. A good advisor will not only select investments but will also develop sound policies to manage the fiduciary component of the plan and limit a plan sponsor's liability exposure. Also, the financial advisor will serve as an ombudsman if issues arise with service issues from other plan providers. While you can handle investments on your own, the high duty of care needed as a 401(k) plan fiduciary, warrant the need to hire a financial advisor. You can't substitute the role of a financial advisor by randomly selecting investment options for the plan.



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