Reasons When Plan Sponsors Should Change Their Plan Providers

By Ary Rosenbaum, Esq.

People are afraid of change and sometimes; change can be a good thing. Change for the sake of change isn't a good idea and there are times when change is absolutely necessary. This article is about when it's probably a good idea for a plan sponsor to change plan providers.

Problems with Form 5500. One of the major responsibilities that a Third Party Administration Recordkeeping Firm (TPA) has in providing services to the plan sponsor is a signature ready Form 5500 for electronic filing. The Form 5500 is the annual tax return for a qualified plan. The Form 5500 includes asset information, liabilities, and plan expenses. Any errors in the Form 5500 just like with errors in an individual taxpayer's Form 1040 will increase the likelihood of a plan audit by the Internal Revenue Service (IRS). If correct data by the plan sponsor is given to the TPA and errors litter Form 5500, then it might be time to find a new TPA.

Failure to amend the plan document. There are constant requirements by the IRS for plan sponsors to either amend or amend and restate their retirement plan document. Amendments are usually required annually or every two years and restatements are required on a 5-6 year cycle. The IRS has deadlines for these amendments and restatements and failure to comply may result in penalties, plan disqualification, or a voluntary correction program that will cost thousands in legal fees and IRS sanctions, If the 401(k) plan is handled by an ERISA attorney or the legal department of the plan sponsor's TPA, there should never be a reason why a plan document cannot meet the amendment or restatement deadline. Failure to amend or restate the plan document by the applicable deadline is a disqualifying plan provision. Any ERISA attorney or TPA legal department that fails to inform the plan sponsor on the need to amend the plan document or restate is threatening the 401(k) plan's qualification, threatening the plan sponsor's previous deductions for plan contributions, and the participant's tax deferred retirement contributions. If their incompetence puts the plan sponsor at risk, they should be replaced.

Lack of fee transparency. Plan sponsors have a fiduciary duty to know the cost of their plan's administration and to determine whether those fees are reasonable for the services provided, when compared to the rest of the retirement plan marketplace. With regulations requiring plan providers to provide fee disclosure to plan sponsors, there should be no reason why plan providers can't reveal their true cost of administering the plan as well as the compensation they receive. Even with required fee disclosure, it's still possible that a plan provider can be less forthcoming or deceptive with their fee disclosure. The only way to make the sure the full disclosure is true is to compare that plan provider's fees to the competition. Plan providers that fail to provide fee disclosure or are deceptive with that disclosure put the plan sponsor at risk for liability from plan participants and the Department of Labor (DOL) and should be replaced.

Incorrect Discrimination Testing Results. As long as the data submitted by the plan sponsor is done correctly, there should be no reason why discrimination testing for participation, deferrals, matching, and top heavy should be done incorrectly by TPAs. Years ago, a law firm client of mine left a TPA because of fee disclosure issues and two years later discovered that the former TPA incorrectly labeled a partner and another partner's wife and daughter as non-key employees for the top heavy test. Had the test been done correctly two years earlier, the client would have made a $28,000 corrective contribution and likely would have implemented a safe harbor plan design to correct it going forward. The old TPA eventually refunded some of their previously collected fees to correct the error, but the damage was done. A TPA is hired for their expertise in administration and recordkeeping. If a TPA operates in a negligent manner, it's time to consider changing that TPA because any errors that threatens the tax qualification of the plan puts the plan sponsor at risk for penalties levied by the IRS and the DOL, as well as litigation from plan participants.

Consistent Failure of Discrimination Tests without Discussion Of The Alternatives. While it is not an actual error, a consistent failure of the plan's discrimination tests without an explanation of any design alternatives by the TPA is a reason to consider making a change. I have a client who was consistently failing the actual deferral percentage test (ADP) where the owner of the company had to receive $10,500 in corrective refunds. The payroll provider TPA never bothered to discuss the benefits of a safe harbor plan design or the fact that the failed discrimination testing with a $7,500 fully vested, non –qualified elective contribution. Needless to say, the client changed providers after making the corrective contribution.

Incorrect Contribution Allocations. While the plan sponsor makes the employer contributions to the Plan, it is the TPA that determines the amount of the allocations that should be made to the participant's account. Any error made by the TPA in such an allocation means that the plan sponsor is not following the terms of the plan and puts the plan at risk for penalties if discovered by the IRS on audit. Any TPA making such allocation errors might derive to be replaced.

Lack of an Investment Policy Statement and Investment Review. Whether the 401(k) plan's investments are trustee or participant directed, every plan must have an investment policy statement (IPS) and a semi-annual or annual review of plan investments to determine whether they still meet the requirements of the IPS. It is probably the most important role of the plan's financial advisor and if it's not being done, then the reason for that financial advisor's employment with the plan has been eliminated. Plan sponsors need all the help they can get in managing the investment selection process, so they need a financial advisor that can correctly follow the requirements of prudent fiduciary management and ERISA §404(c) if the plan is participant directed.

Lack of Investment Education to Plan Participants. The biggest misnomer concerning ERISA §404(c) is that plan sponsors have their liability fully limited when it comes to a participant's losses if the participant directs investment. The limitation on liability is a sliding scale, depending on the education given to participants on the investments offered in the Plan. So the more investment education you give to participants, the more protection from liability you get. Having your financial advisor provide Morningstar profiles to plan participants won't do the job. A financial advisor who won't provide sufficient investment education to plan participants should be considered for replacement. While some financial advisors feel that providing investment education isn't one of their strengths, they can certainly hire a company like RJ20 or other companies that provide education to participants to help with the task. At the end of the day, the plan sponsor is on the hook for not providing enough investment education while the plan advisor that didn't provide enough of it will still be collecting their fee.

Lack of an ERISA Bond, The DOL made it clear that an ERISA bond is required when the plan has employees as participants. While the procurement of an ERISA bond is completely on the shoulders on the plan sponsor, the fact is that IRS Form 5500 asks the question of whether there is such a bond. If the TPA checks no, based on the plan sponsor's information, I believe that any competent TPA would bring that lack of a bond to the plan sponsor's attention because of that DOL requirement. Again, it's the plan sponsor's responsibility to get one, but I believe that it's the TPA's responsibility to point it out.

Proper 401(k) Plan administration is a very difficult job and errors certainly errors occur. However, there are some errors that threaten the plan's tax qualification status and increase the plan sponsors and trustees' fiduciary liability. With those errors, it is incumbent in the plan sponsor and trustees' role as plan fiduciaries to determine whether a c change in the plan provider that caused these errors should be replaced. While it may be the plan provider's negligence, it is the plan fiduciary that ends up holding the bag.

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