Free Advice For 401(k) Plan Sponsors

By Ary Rosenbaum, Esq.

They always say there is no such thing as a free lunch because most of the time, free has strings attached. Even when it comes to retirement plans, that free plan review is usually a sales pitch by a retirement plan provider that is seeking business (there is nothing wrong with that by the way). I'm an ERISA attorney who has almost 19 years of experience with working on retirement plans and one of the toughest problems is that when I give advice, people grab their wallet in a fear that my advice comes with a huge legal bill. This article is free advice for all 401(k) plan sponsors out there on how to improve their plan and avoid liability. If you have further questions, feel free to contact me.

A 401(k) plan is like every other employee benefit, but unlike any other benefit

Plan sponsors forget sometimes that their 401(k) plan is supposed to be an employee benefit. An employee benefit is a tool to recruit and retain quality employees. It may not get the attention that health insurance does or free milk with coffee, but a 401(k) plan can be an attractive tool that can help an employer maintain a workforce that can help them be more productive and efficient. What makes a 401(k) plan different from other employee benefits is that the plan sponsor is wearing two hats: as a plan sponsor and as a plan fiduciary. A 401(k) plan sponsor is also a fiduciary because they are responsible for the retirement assets that their employees have in the Plan. What does that mean? That means a 401(k) plan sponsor has a duty of care to those employees who have money in the Plan and they must exercise that duty in a prudent fashion. If an employer runs out of milk for the coffee, someone in the office can just go out and buy a gallon at the local deli. If an employer does something that negatively affects their 401(k) plan, they don't get off so easy because they have the highest duty of care in law and equity because they're a fiduciary.

In the end, the buck always stops with the 401(k) plan sponsor

Thanks to that thing called fiduciary duty, the 401(k) plan sponsor will ultimately be on the hook for liability. To understand what that really means, you have to understand that the plan sponsor is also responsible for what plan providers do. So if a third party administrator (TPA) fails to prepare the annual Form 5500 or makes a mistake in compliance that gets caught on an Internal Revenue Service (IRS) audit, it's the 401(k) plan sponsor that is ultimately responsible for those errors. If the financial advisor doesn't help the plan sponsor select good investments or picks mutual funds that are retail share class when institutional share class is available, the 401(k) plan sponsor is ultimately on the hook for liability. Sure a 401(k) plan sponsor can certainly sue a provider for malpractice, but that's after the plan sponsor pays through the "nose" by being responsible to fix the plan. While there are plan providers such as ERISA §3(16) administrators or ERISA §3(38) fiduciaries that will assume the liability in the plan administration and fiduciary process respectively, a plan sponsor may still be liable for hiring negligent providers if something does go wrong. I've seen plan sponsor sued for millions of dollars for mistakes made by plan providers and the reason is because they are ultimately responsible for what goes on with their plan, no ifs, ands, or buts.

Small and medium sized plan won't be sued in a class action, but that's the least of their worries

Over the last 10 years, more and more 401(k) plans are being sued for a wide variety of reasons, but mostly about fees. These lawsuits tend to be class action lawsuits against large employers. The reason that large employers are targeted is because they have large 401(k) plans that should pay less in fees as a percentage of plan assets and most importantly, they have large pocketbooks. When ERISA litigators can get a third in fees of any settlements plus costs, it's easy to figure out that litigation against 401(k) plans can be rewarding. While I've always talked about the liability pitfalls a 401(k) plan may have, people always say that small to medium sized plans don't get sued. While small and medium sized plans are likely safe from class action lawsuits because of the lack of a big settlement that ERISA litigators can bank on, the fact is that class action litigation is the least of small to medium sized 401(k) plan sponsor's worries. Small to medium sized employers wont

get sued in a class action, but it doesn't mean they can't get sued by individual plan participants and there have been a couple. It also doesn't mean they can't get sued by an aggrieved former employee who just wants a quick settlement as some sort of retribution for a justified layoff. It also doesn't mean they can't be the subject of an Internal Revenue Service (IRS) and/or Department of Labor (DOL) audit. I've handled enough audits to know that plan sponsors can pay in the tens of thousands of dollars for any compliance errors discovered on an audit. So a plan sponsor may not need to worry about a class action lawsuit, but mistakes on their end could risk the ire of a lawsuit from an individual plan participant or problems with the IRS and/or DOL. Good plan sponsor habits like good dental habits can keep a big bill later down the line, I've seen audits that are far worse than any root canal.

The most important plan provider is the TPA

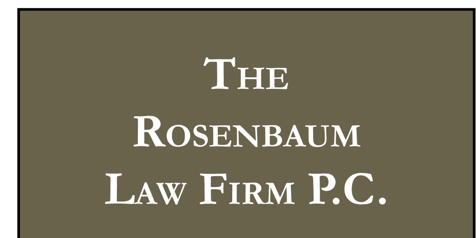
There are many great plan providers out there like the ERISA attorney I see in the mirror everyday, but the fact is that the most important plan provider that a plan sponsor selects is the TPA. The reason why is because the TPA does the bulk of the work and they are usually the big difference as to why 401(k) plans run efficiently and why they may not. Being a TPA isn't just about plan administration and compliance, it's a lot about keeping the 401(k) plan running efficiently through the use of plan design formulas or in combination with another retirement plan. Too often, 401(k) plan sponsors select TPAs for the wrong reason such as because they also do their payroll or because the TPA happens to be very cheap. The best TPAs out there are the ones that can do their job competently, efficiently, and help the plan sponsor avoid compliance headaches and utilize plan design options that will allow plan sponsors to optimize their use of their retirement plan. I've seen too many plan sponsor either leave money on the table that they could have used to reward their highly compensated employees or waste money with design options that don't efficiently use employer contributions. Patients don't seek doctors based on price, plan sponsors should seek TPAs based on their quality in service and that they charge a reasonable fee.

It's all about a process and not a result

My children are in elementary school and I hate the way they teach math. It's more focused on the process in finding the way to an answer rather than finding the right answer. They're more focused on the process and not about the result. While I think that's the wrong way in teaching math, it's actually the right way in running a participant self-directed 401(k) plan. In a self-directed 401(k) plan, the participants pick their own investments and if certain processes are followed, the plan sponsor isn't liable for what the participant may lose in their own account. So many 401(k) plan sponsors think that they have no liability with these types of plans; they do have liability issues if they don't follow a prudent process in running their plan. I worked at a law firm where the human resources director running the plan didn't hire a financial advisor, didn't review the investment options for 10 years, and didn't give investment education materials to plan participants. So even if participants directed their own investments, the law firm would have been liable for any losses incurred by participants because they didn't follow a prudent process until I advised them on their plan. We're trained so much in life about winning and coming in first and being a plan sponsor isn't about getting the best investment return out there, it's really about jumping through hoops and following a prudent process in selecting plan providers, paying reasonable fees based on the services provided, and putting participants in a position where they can make informed investment decisions. Following a process should be easy, but the fact is that most small to medium sized 401(k) plans don't do that and that's usually because they rely on a plan provider that really doesn't take the prudent process of running a plan very seriously.

The Plan needs to be reviewed

My mother doesn't go to the doctor because she doesn't want to know if there is anything wrong and that going to the doctor will make sure that there is something wrong. It's silly and a good friend of mine died before he was 40 because he was too late in seeking medical attention for a cancer that could have easily been cured. While someone's health isn't on the same level as the health of a 401(k) plan, it's still shocking how many plan sponsors just don't want to bother with spending a couple of dollars in having their retirement plan reviewed by an independent retirement plan consultant or ERISA attorney. A review by a current plan provider maybe a little self-serving, so I recommend an independent review. I charge $750 for such a plan review and to this day, I've done less than 20 in the last 7 years because plan sponsors don't want to bother even though they could actually pay that fee from the plan and not out of their pocket. Like my mother, they don't want to know. More often, they don't know that they need to know. So plan sponsors need to know that a good plan review can detect problems before they become costly problems.



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