Great 401(k) Features That Aren't A Fit For Every Plan Sponsor

By Ary Rosenbaum, Esq.

When you're trying to buy a product or service, many times you're being oversold things that you don't need like that extended service warranty on a cheap Blu-ray player or etched glass on a new cae. Well, retirement plan sponsors are sold services that many times they really don't need. The problem is that unlike the etched glass, plan sponsors really don't whether a service for the retirement plan is necessary for their needs. As I often say, there isn't a retirement plan solution that is appropriate for every plan sponsor out there. Everything that a retirement plan sponsor should get is something that actually fits their needs. This article is the many services offered for retirement plan and when plan sponsors should say no thanks

Safe harbor 401(k) plan design

Prior to 1999, 401(k) plans that had issues with their deferral discrimination and the top-heavy test could only fix their plan with corrective contributions and/or refunds. A safe harbor design was created by the Internal Revenue Service (IRS) through guidance that allowed 401(k) plan sponsors to get a free pass on some discrimination tests in exchange for fully vested required contributions with a notice to participants ahead of time. This was a great opportunity for plan sponsors who failed their testing. The only problem with the safe harbor is the cost of the contribution, a 3% non-elective (profit sharing) contribution or a match that could be as high as 4% of compensation. So it makes no sense for the plan sponsor who is consistently passing their discrimination test to complicate their situation by opting for a required employer contribution they don't need. A safe harbor plan design is great for the plan sponsors who actually need it. Even for the plan sponsors that need a safe harbor plan design; sometimes they've been advised to pick the wrong one. For example, the 3% non-elective contribution can be used in conjunction with a cross-tested plan design that offers higher contributions to highly compensated employees, but the 4% match can't. Also, plan sponsors may have been told to opt for the 3% non-elective contribution when a 4% match was more affordable (since the non-elective requires contributions for those that don't even defer). Like with every other retirement plan feature, a safe harbor plan design isn't for everyone.

Pushing only 401(k) plans

401(k) plans have been the main private employment retirement savings vehicle for the past 20+ years. The reason for the switch from defined benefit plans to 401(k) plan are mainly economical as the cost of funding retirement was shifted from the employer to the employees. In addition, technological advancements on the Internet and the proliferation of mutual funds have made participant-directed 401(k) plans as a desired option for the employers. The problem with a 401(k) centric practice is that many retirement plan providers push 401(k) plans so exclusively, they forget that certain employers could benefit by the addition of another qualified like a defined benefit plan or cash balance plan. A cash balance plan works great in tandem with a safe harbor 401(k) plan so that the retirement savings for the owners and highly compensated employees of a plan sponsor can be maximized. I think every employer should adopt a 401(k) plan, but it doesn't mean that it should be the exclusive retirement plan for the plan sponsor if they could afford minimum contributions to the rank and file employees and increased contributions to the owners and highly compensated employees. Too often plan sponsors hire third-party administrators such as payroll providers who have limited knowledge of plan design, so that uses of another plan can't be used and plan sponsors end up leaving money on the table that gets taxed instead of deducted.

Automatic enrollment of 401(k)

The automatic enrollment feature that allows 401(k) plan sponsors to automatically enroll employees who fail to decline to defer in the plan is growing in popularity since it was finally codified into law in

2006. Getting employees to involuntarily defer their income for retirement can be a good thing if it helps with deferral compliance testing, as well as getting employees to save for retirement. However, automatic enrollment isn't a great feature for everyone. There are enough plan sponsors out there with no deferral discrimination testing issues and/or having an employee base that might not be receptive to automatic enrollment because of high participation already or they are lower-paid employees who can't afford to defer. While automatic enrollment may be the best thing since sliced bread for many 401(k) plan sponsors, it isn't the solution for everyone.

A discretionary corporate trustee

A qualified retirement plan consists of a plan and trust. The trust holds plan assets, so every plan must have one and have plan trustees. For most plans, the trustees are owners or employees of the employer. Retirement plans could also have a corporate trustee where a trustee could serve in a discretionary (where they have a very limited say) or non-discretionary (where they could call many of the shots) role. The discretionary role is the most common type of corporate trustee, where the trustee signs off on the plan's trust statement and signs distribution checks while remitting withholding to the government. While corporate trustees aren't prohibitively expensive, they aren't a fit for everyone. Corporate trustees are good for only two types of retirement plans: those that require a plan audit and those where no one wants to volunteer to be a trustee. For those that require a plan audit for their Form 5500, the reason to hire a corporate trustee is that they can qualify for a less expensive limited scope audit because the trust company can certify the plan's trust statements. Of course, for those plan sponsors where no one wants to serve as a plan trustee, a corporate trustee is a perfect fit. Otherwise, a plan sponsor may be throwing out money by having a corporate trustee they don't need.

An ERISA §3(16) plan administrator

Another great fiduciary service that many plan providers are offering including yours truly is ERISA §3(16) plan administration. This is where the provider assumes the role of the plan administrator and the liability that goes with it. Being a plan administrator is a giant headache; so many retirement plan sponsors may opt to delegate the liability and headaches that go with it to a plan provider that has the experience to do a better job. As with everything out there, §3(16) administration may not be the right fiduciary solution for every plan sponsor. I've been an ERISA attorney for more than 19 years now, so I know of many plan sponsors that have the staff to effectively run and manage a retirement plan. Retirement plan sponsors who have a human resources staff and/or executive financial leadership that can effectively manage the day-to-day operation of their retirement plan don't need to pay the added expense of hiring an ERISA §3(16) plan administrator. ERISA §3(16) is for those plan sponsors that don't have the background or desire to handle the day-to-day of plan administration.

An ERISA §3(38) fiduciary

Many financial advisors offer their role as a plan fiduciary in different capacities, levels of service, and levels of pricing. Registered investment advisors can offer an ERISA §3(21) service where they serve in a co-fiduciary role with no discretion. That means that while the financial advisor prepares the investment options available under the plan, drafts the investment policy statement (IPS), and offers education to plan participants: the ultimate decision-maker is the plan sponsor. §3(21) is different from an ERISA §3(38) service where the financial advisor has discretionary control over the fiduciary process. That means the ERISA §3(38) defined "investment manager" has the full say over the investment options, the IPS, and providing education to plan participants. Akin to the ERISA §3(16) service, the §3(38) fiduciary is assuming the liability of the fiduciary process of the plan. While this may be a great fit for plan sponsors who just want the registered investment advisor to handle everything, it's not a great fit for everyone. There are many plan sponsors who are on top of all aspects of their retirement plan and there are plan sponsors who don't feel comfortable in giving all the power and liability away. So there are many plan sponsors out there that may just be better off with a co-fiduciary role for their financial advisor and not bother with betting the bump up in cost for the §3(38) service.

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