401(k) Plan Sponsors Need To Turn The Lights Back On

By Ary Rosenbaum, Esq.

I live on Long Island, so the joke is by law, I must like Billy Joel. Honestly, I've been a fan since about 7 or 8 when my Aunt had the Glass Houses record. After a long time of not writing any music, Billy is back with "Turn the Light Back On." It's a song about regret and mistakes. The song has been in my head for weeks and the AI-created music video showing Billy when he was younger is an all-time classic and would be an MTV staple if MTV still showed music videos. Many 401(k) plan sponsors may have many mistakes and some regrets if they knew the mistakes they were making. They certainly could turn the "lights back on" for their 401(k) plan.

It's neglect, not intent

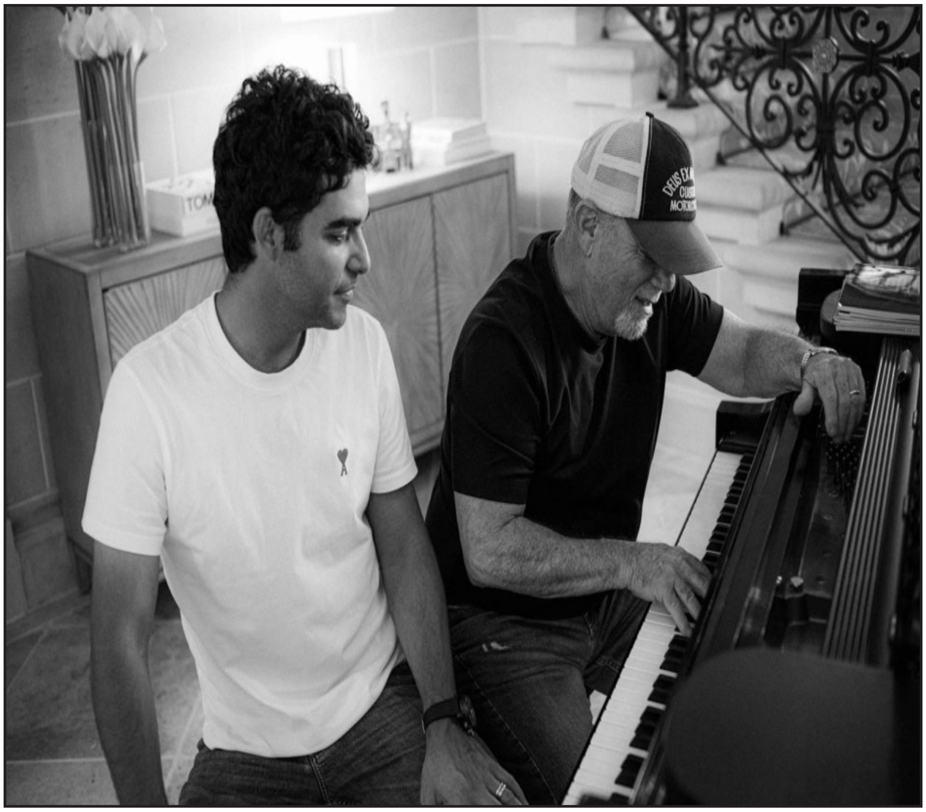
I don't think a 401(k) plan sponsor sets out to create a lousy plan. The poet Robert Burns once wrote: "The best-laid plans of mice and men often go wrong." That means plan sponsors might have started the plan with the best of intentions, but things went wrong. What usually goes wrong is neglect by the plan sponsor. Running a business isn't easy and 401(k) plans aren't high on an employer's list. When it comes to employee benefits, 401(k) plans can't compete with pay and health insurance. Too many employers are small and medium-sized, so they may not have someone with a human resources background in charge of running the 401(k) plan. Many times it's the owner the office manager or the spouse of the owner. There is rarely a willful intent to run a poorly run 401(k) plan unless the plan sponsors want to use the 401(k) plan as their own personal bank account to prop up their business (people do go to jail for that), which doesn't happen that often. The whole point of starting a plan was so that it could serve as a way to recruit and retain employees. Poorly run plans are a strike for current and potential employees. A plan sponsor will have regrets if their 401(k) plan scares away current and potential employees. It's never too late for plan sponsors to turn the light back on.

Looking at the plan design

Plan designs are like suits, they need to fit. I think I've worn a suit once in the last 4 years since COVID broke and if I gained a couple of pounds, I'll need to let it out. Plan provisions that might have been fine when the plan started, may no longer be a good fit today. If turnover at the businesses is high, it might be a good time to look at the service requirements for participation or employer contributions. If participation is low on the salary deferral component to the point that deferral testing is negatively impacted, perhaps Automatic Enrollment is a solution. Whatever needs to change can only happen if the plan sponsor is no longer indifferent and looks at the plan provisions. That means the plan sponsor has to sit down with their third-party administrator (TPA) and/or their ERISA attorney to see if the plan design still fits their needs. When a plan is set up for 3 employees, things might need to change if there are 25. What was good then, may not be good now.

Looking at the plan providers

401(k) plan sponsors need to understand that even if they have plan providers working on their plan in a fiduciary capacity or not, they will still be responsible for the mistakes caused by these plan providers. That is why it's extremely important for plan sponsors to review their plan providers every now and then. Plan sponsors need to make sure the plan providers are doing the jobs as promised, and doing it well. Plan errors are usually discovered on a government audit or when the plan sponsor changes TPAs, this is when they discover there are a lot of holes and a lot of problems are buried in those holes (Casino is a top 10 favorite movie of mine). Reviewing the plan's administration and the providers helping with it goes a long way in minimizing the potential for undiscovered errors. It's important to fix errors as they happen because they're far costlier to fix later. Certain fixes such as refunds to highly compensated employees because of a deferral testing failure aren't an option if the error is detected years later.



Looking at costs

I have been in my house for the last almost 19 years and one of the biggest drawbacks I've had has been dealing with home contractors. My wife and I actually had to sue one in court for doing shoddy work and failing to complete an expansion because we didn't want to accede to their exorbitant demands for remediation work after Hurricane Sandy. Until we hired another contractor, we had no idea that the previous contractors were too expensive. That's on us. When a plan sponsor is a plan fiduciary, responsible for the retirement assets of others, overpaying for services isn't an option and is an actual breach of fiduciary duty. I started in this business in 1998 and it's still kind of amazing to realize that for the first half of my career, plan providers weren't required to let 401(k) plan sponsors how much they were directly or indirectly getting paid to provide services to the plan. That was a huge problem when plan sponsors were responsible for only paying reasonable fees for the services provided. A big problem in the industry was when TPAs and financial advisors were pushing plan sponsors away from cheap index funds to managed funds that had higher fees, but paid revenue-sharing fees to the TPA for plan administration. Plan sponsors were told that having index funds in their 401(k) plan made the plan more costly to administer and not telling plan sponsors that the higher cost revenue sharing paying funds were a factor in considering the pricing of their plan. There were a handful of unscrupulous TPAs that would shift a 401(k) plan sponsors to a revenue-sharing program under the same custodian and claim they were also slashing fees, but not tell the plan sponsor that they ended up making more money on the plan through revenue sharing. It was these issues that led the Department of Labor (DOL) to implement fee disclosure regulations in 2012. Fee disclosure regulations were a game changer because both the plan sponsor and plan participant would know how much was being paid in fees to plan providers. Fee disclosure isn't a perfect system, but it created transparency and it created a competitive environment that led to fee compression. The problem with fee disclosure mostly, is that small and medium-sized plans through disclosures in the garbage and don't pay attention. Fee disclosures aren't like the bank's privacy policy statement. It really serves as a directive to get plan sponsors to benchmark their fees. The only way to do that is to compare fees with plan providers, providing similar services because plan sponsors don't have to pay the lowest fees, just reasonable fees. Comparing fees doesn't require that much work, shelling out $95 for the latest 401(k) Averages Book is a good and inexpensive start. Plan sponsors need to turn the lights back on by understanding they have a fiduciary duty to pay only reasonable plan expenses and they can breach that duty by doing nothing.

Looking at giving participants the tools to succeed

Most 401(k) plans these days have participants directing their own investments. While it's exciting to give participants the chance to direct the investments of their retirement account, it could offer plan sponsors the chance to minimize their liability for losses sustained by participants under ERISA §404(c). The problem with participant-directed investments, the selling point was flawed. The selling point was flawed because they didn't tell plan sponsors that the liability protection wasn't unlimited, the plan sponsors needed to provide enough information for the participant to make informed investment decisions. That isn't possible if no education is given to participants on the basics of investments, as well as an updated fund lineup. They hate when I mention the old law firm I was a part of, but when the 401(k) plan had no advisor, no education materials, and the plan's fund lineup wasn't updated for 10 years, liability protection would have been close to zero. Plan sponsors need to make sure that participants have the ability to get the best retirement outcome. That means hiring a financial advisor who can effectively manage the plan's fiduciary process with investment selection and giving education to participants to make better investment choices.

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