401(k) Options That Plan Sponsors Should Pass On

By Ary Rosenbaum, Esq.

I haven't bought a car in almost 12 years. While I used to be the guy who would lease a new car every 3 years, low interest rates and the elimination of the monthly lease payment, had me buy my cars after Hurricane Sandy killed off the previous two cars. One feature of buying cars is options and there are certain options I remember that were kind of silly, such as paying for etched glass to deter thefts. If they can only track my car through the Vehicle Identification Number on the glass window, I don't want the car back. That being said, there are plenty of options out there for your 401(k) plan that might seem attractive, but you should probably reject them. This is all about 401(k) plan options, you should pass as a plan sponsor.

After-Tax, Roth Employer Contributions

One of the provisions in SECURE 2.0 allows plan participants to elect to have any employer contributions funded to their 401(k) plan made as a Roth contribution. Like with Roth salary deferrals, participants making such an election will owe income tax on the contributions but will avoid tax on qualified distributions of both principal and income. Unlike mandatory Roth contributions for participants for catch-up contributions who are Highly Compensated Employees (I assume that will be effective in 2025), this is an optional provision. I would not recommend this provision to any plan sponsors, because I think it will be a lot of work for the one or two employees that can afford it and want to do it. The biggest problem with this provision is that any Roth employer contribution would have to be fully vested. If you have a vesting schedule because you use it to entice employees to stay, then you have to treat these Roth electors as extra special and vest that at 100%. In addition, there is a headache of recordkeeping. Since it's an employer contribution and the participant will have to pay tax on it, there is the issue of tax reporting. If a participant elects to receive matching or nonelective contributions (profit sharing) as Roth contributions, the Roth contributions are treated as an in-plan Roth rollover and must be reported on Form 1099-R (and not a Form W-2) for the year in which the contributions are allocated to the employee's account (even if the contributions are designated for a prior year). Roth contributions will not be subject to FICA taxes, and federal income tax withholding does not apply. So, the participant would need to adjust their tax withholding to avoid owing additional income tax at the end of the year. One would assume the Third Party Administrator (TPA) would be the one issuing a 1099R, and let's be honest, they're going to want to be paid for this work. While I love the idea of Roth IRAs and Roth 401(k) deferrals, I think it's Roth employer contributions are too much work for you to implement, because I don't believe that they will be very popular.

Emergency Savings Accounts

Secure 2.0 allowed a lot of optional provisions for plan sponsors. One nugget is something the Department of Labor (DOL) calls Pension Linked Emergency Savings Account (PLESA). PLESAs are tied to a defined contribution retirement plan, such as a 401(k) plan. A PLESA balance is capped at $2,500 (which may increase over time because of inflation), and participants would be able to withdraw from the account at their discretion without paying a 10% early withdrawal fee. Unlike hardship distributions, participants will not be required to prove a hardship, or even be experiencing one, to take money from a PLESA; withdrawals may be taken at "the discretion of the participant." This PLESAA provision is separate and apart from, Section 115 of SECURE 2.0, which also allows for one penalty-free withdrawal of up to $1,000 per year from a 401(k) account for emergencies. Like with Roth employer contributions, this is something I would not recommend for plan sponsors to implement. The contributions made to these PLESA accounts are like the old voluntary contributions made to 401(k) plans before Roth. Participants would elect to make these contributions on an after-tax basis. As a plan sponsor, along with your TPA doing the actual job, there would need to be separate recordkeeping. With contributions capped at $2,500, that seems you would need to do a whole lot of work for a small amount of money. I have been through more emergencies in my life than I needed (thank you Hurricane Sandy) and most emergencies would be greater than just $2,500. I understand the tax-free nature of this money in PLESAs, but they should be since it's after-tax money. In a

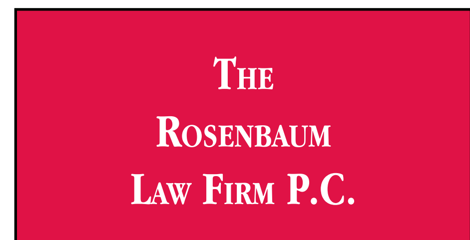
bind, some provisions allow participants to tap their 401(k) savings in times of emergencies. That would be a loan provision and hardship distributions. I understand a hardship distribution will impose that 10% withdrawal penalty, but the money is there for participants, well over $2,500 in the PLESA (plus earnings). While many large company 401(k) plans will implement this provision, I just don't think it's worth the time and effort for most small and medium-sized plans.

Self-Directed Brokerage Accounts

I will not be Don Quixote of the retirement plan industry, and fight against participant-directed 401(k) plans. I still believe that financial advisors and investment managers are far better at making investment decisions for plan participants. I can't compete with the popularity of mutual funds, daily valuations, and the assumed protections that you get from participant investment direction under ERISA §404(c). The ship for participant direction of investments set sail about 25 years ago. As far as Self Directed Brokerage Accounts (SDBAs), I will still state my objection. SDBAs bring a whole host of problems, issues, and questions. For years, I joked that SDBAs were wanted by companies that were law firms, accounting firms, and medical practices. Then, I found out it wasn't a joke. There are other companies that wanted SDBAs or implemented them, that aren't these professional services firms. The problem with offering SDBAs is that most plan sponsors don't understand that SDBAs have to be offered to all participants because we can't have benefits, rights, and features that discriminate in favor of highly compensated employees. It was only when I was leaving my old law firm, that I realized that SDBAs were offered in our 401(k) plan, but only to certain partners of the law firm. If audited by the government, they would have had a huge problem. One of the self-important partners of the firm who did tax certiorari work (fighting property taxes), even had his broker work on his account, outside of the 401(k) plan's financial advisor. Many SDBA holders want to employ their financial advisors in the plan. I doubt plan sponsors are vetting these advisors. In addition, using an outside advisor from the advisors that the 401(k) plan uses, might increase what the participants who don't have a brokerage account, pay since brokerage accounts won't pay for the 401(k) plan's advisor. Another issue is that most plan sponsors don't monitor what is going on in SDBAs. As a plan sponsor, you are a plan fiduciary for all assets, including assets in brokerage accounts. If participants are making wild bets in SDBAs, are you going to discuss it with them? If they're a principal in the company, probably not. Another issue these days is Bitcoin and other crypto investments. The DOL, right now, has issues with crypto investments being allowed by participants because of volatility and security concerns. Thanks to the approval of Bitcoin ETFs, they should be easily accessible within SDBAs. I doubt many 401(k) plan sponsors would restrict access to these ETFs, which could put the plan at risk, during an audit. In addition, it's never really settled as to whether you will be held harmless from losses sustained by participants within their SDBA. The assumption is you are, but I'm waiting for litigation from a participant who put in 100% of their retirement savings into a volatile stock, lost money, and sues. Participants in SDBAs don't do better than participants who just use the plan's core investment lineup. I understand that participants have access to thousands and thousands of investment options, but a 401(k) plan isn't a casino. There are just too many issues for me to recommend SDBAs to any 401(k) plan. I'll be the stick in the mud and tell you that it's an option you should punt on.

Annuity Payment Option

While 401(k) plans were allowed to eliminate annuity options within their plan years ago, the government and the insurance industry want them back in. I understand the need for lifetime income and that participants need to make sure that their retirement assets will allow them to live in retirement. If participants want an annuity, they could easily buy one from their distribution when they retire or terminate. I hate being volunteered to do extra work, so I will never volunteer a 401(k) plan sponsor to do extra work either. Annuity options and insurance carriers would need to be vetted by you. I prefer just offering that lump sum option for payment, so you can pay a former participant a lump sum, and let them leave.



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The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw