How Plan Sponsors Can "Reboot" and Improve Their 401(k) Plan

By Ary Rosenbaum, Esq.

In movies and television, a reboot is a mechanism to discard all previous continuity in a series and start anew with fresh ideas. So all established fictive history is irrelevant to the new storyline, and the series is started over as if it's brand new. So reboots are attempts to rescue franchises that have grown "stale". The Daniel Craig James Bond movies can make us all forget Roger Moore in space in Moonraker and Pierce Brosnan's invisible car in Die Another Day. The Christopher Nolan Batman Trilogy certainly made us forget George Clooney's nippled bat suit in Batman and Robin. However, in my mind, only Jack Lord can play Steve McGarrett in Hawaii Five-O. When it comes to 401(k) plans, plan sponsors can reinvigorate their retirement plan by revamping or "rebooting" it through new options that could improve how it operates as an employee benefit. So this article is how about plan sponsor can improve their 401(k) plan through a "reboot".

Reviewing Plan Providers

Clearly, a plan that needs a reboot is a plan that is obviously stale. So if the plan is stale, perhaps this is a result of the current plan providers, whether it's the financial advisor or the third party administrator (TPA) or the ERISA attorney. Whether the fault lays with them, within, or a mixture of both, it's a plan sponsor's responsibility, regardless of any blame, to review plan providers for competence and fees. As a plan sponsor looks to reboot their plan, this is a great opportunity to review the plan providers.

Adding Automatic Enrollment

The lack of participation rate of employees in deferring their salary in a 401(k) plan is a two-part concern. First, people aren't saving enough for retirement and a low participation rate by a company's non-highly compensated employees may negatively impact the deferral savings for highly compensated employees because of failed discrimination testing. Automatic enrollment is a feature that defers a participant's income automatically if a participant fails to affirmatively waive participation in the salary deferral component of the plan. Automatic enrollment artificially increases plan deferral participation, which can help with required plan discrimination testing as well as increasing plan asset size, which can decrease the cost of administering the plan. It also makes a statement that the employer is interested in the welfare of their employees by having them set aside a portion of their income for retirement. Through encouragement by the employer and investment education by the plan advisor, it is the hope that these automatically deferring participants may be converted into active deferring participants.

Adding A Roth 401(k) Feature

While most plan participants can't afford to do it, a Roth 401(k) option can be a nice addition to a Plan. A majority of plans have still failed to add this feature and there should be no reason why because it doesn't complicate plan compliance and participants should have the opportunity to decide whether to defer some or all of their salary deferrals as after-tax and enjoy that tax free growth. Roth 401(k) allows a participant to designate some or all of their deferrals on an after tax basis, allowing for tax-free distributions at distribution if certain requirements are met. There should be no added cost to adding this feature (except for a plan amendment). Also, the addition of a Roth 401(k) feature allows eligible plan participants (those older than 59 ½ or normal retirement age) to convert their pre-tax salary deferrals into Roth deferrals after taxes are paid.

Eliminate Eligibility Requirements for Salary deferrals

This may be the most unpopular suggestion in this article because having immediate eligibility may increase plan costs because it will increase the participant headcount. While that may be true, employers should understand that immediate eligibility for salary deferrals is an attractive employee recruitment and retention tool. When I have interviewed for jobs in the past, a one-year of service eligibility requirements had been a strike against taking a job offer. Immediate eligibility for deferrals doesn't preclude the employee from having a year of service requirement for employer contributions and it won't affect discrimination testing on salary deferrals because under the otherwise excludible rule, testing will be completed as if the plan had an age 21 and a year of service requirement for salary deferrals. Employers often forget than a 401(k) plan is an actual employee benefit and immediate eligibility for salary deferrals is an attractive benefit for any potential or new employee.

Reviewing the Investment Selection Process

Whether the plan is participant or trustee directed, it is incumbent on the plan sponsor to review the investment selection process and whether it complies with ERISA to limit liability. This process requires the retention of a financial advisor, development of an investment policy statement (IPS), selection and review of plan investments based on the IPS, memorializing any decisions taken by the plan fiduciaries in the selection and review of investment options, and employee investment education (if the plan investments are directed by participants). It is often surprising how many plans don't have an IPS, or a financial advisor, or a review of investments to see it complies with the IPS. Heck I worked at a law firm who had a 401(k) plan with all of those deficiencies before I advised them to clean up that potential liability disaster.

Prune an Excessive Fund Line-Up

When it comes to having investment options for participant directed 401(k) plans, many advisors and plan sponsors believe that more is more. Studies suggest that less is actually more because plan participation for salary deferrals is depressed with participant directed plans with large fund menus because it overwhelms participants. I have seen plans with 28 and even 50 different mutual fund options on a single plan menu, which has to confuse plan participants. There should be no reason why a plan has 3 large cap growth funds. Too many fund choices have also been shown to spur participants to invest more in less riskier investments that may negatively affect their asset allocation and their retirement savings. Why have 28 mutual funds in the fund lineup when 12 can do the trick?

Add a Safe Harbor Plan Design

If a plan sponsor can afford a safe harbor contribution to their plans, they should consider it. A safe harbor design is where the plan sponsors makes a fully vested contributions to their non-highly compensated employees on a "profit sharing basis" (3% of compensation to participants whether they defer or not) or a matching basis (usually, matching contributions up to 4% of compensation) or a matching contribution tied to Automatic Enrollment (which is a smaller matching contribution and a 2 year vesting schedule). Regardless of the contribution, it eliminates discrimination testing for salary deferrals and matching contributions, as well as the test to determine whether the Plan is Top-Heavy. In addition, the 3% non-elective "Profit Sharing" contribution can be used in combination with a cross-tested/ new comparability allocation, which allows greater contributions to highly compensated employees. Sure, it will cost money, but it will eliminate a lot of potential compliance headaches.

Complete an Annual Review of the Plan

Retirement plans are like automobiles, they need constant maintenance to run to its optimum capability. Too many plan sponsors have a "drawer" mentality when they take their plan, put it in the back of the drawer and forget about it. A 401(k) plan should be reviewed annually to determine whether the fees being charges are reasonable, whether the investments are still proper according to the IPS, whether the plan still fits the needs of the sponsor and participants, as well as determining whether the plan documents and the plan's administration is compliant with ERISA and the Internal Revenue Code. While plan sponsors may consider this review cost prohibitive, there are many financial advisors, TPAs, retirement plan consultants, and ERISA attorneys (including this one) who can perform that service at a reasonable fee. So whether they use my $750 Retirement Plan Tune-Up or the $1,000 Retirement Plan LegalEase or some other type of review, it should be done as a plan review or reboot.

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