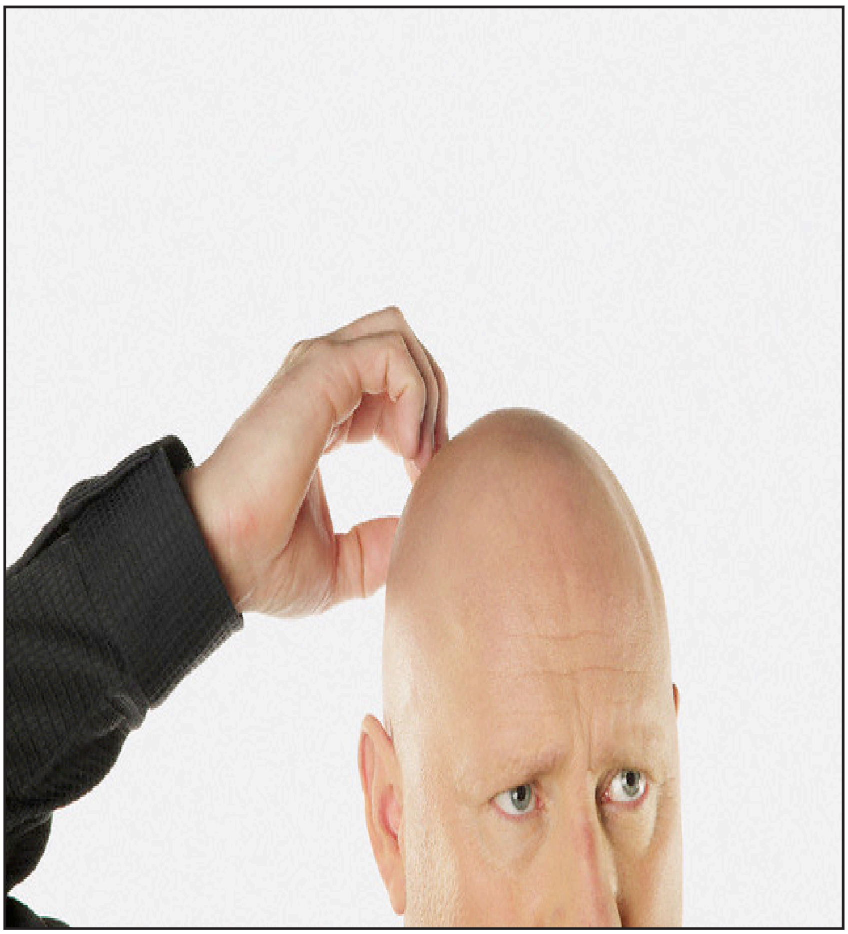
What 401(k) Plan Sponsors Shouldn't Forget

By Ary Rosenbaum, Esq.

It's easy to forget things. Heck, half of the things my wife tells me to do is forgotten by the afternoon. My wife often suggests that I keep a list of things I need to do so I don't forget. Of course, I forget to keep lists. Seriously, a plan sponsor can't afford to forget things because of their role as a retirement plan sponsor. So this article is a list of things that plan sponsors shouldn't forget about their 401(k) plan.



Why they set up the Plan in the first place

Plan sponsors forget why they set up the 401(k) plan in the first place. While it's a good benefit for the plan sponsor's highly compensated employees, it's a good benefit for all employees. Plan sponsors forget that a 401(k) plan is an employee benefit. They forget it's a benefit because unlike other employee benefits, most employees don't understand it and it sort of runs itself on its own or at least the plan sponsor thinks it does, but it really doesn't. A 401(k) plan isn't like the employer provided health insurance plan because costs on the 401(k) plan don't go up 20% annually. It also doesn't get the interest of the K Cup machine either. I worked for a company with a lousy 401(k) plan and employees only complained when the employer stopped providing free milk for the K Cup machine. Plan sponsors need to remember that the 401(k) plan is an employee benefit and they can't forget that it's supposed to be used to entice a good workforce and to act as a retention tool for the workforce.

That they're Plan Fiduciaries

Sponsoring a 401(k) plan is a lot different than sponsoring a company softball team. Sponsoring a 401(k) plan makes the employer a plan fiduciary. Being a plan fiduciary requires the highest of duty of care in equity and law. From what I recall, sponsoring a softball team takes a lot less. Being a retirement plan sponsor means being responsible for the retirement money of the plan's participants. Plan sponsors can be reckless with their own money, but they need to safeguard the retirement money of their employees. Safeguarding their money isn't just about making sure it isn't stolen; it's taking a consistent look at the inner working of the 401(k) plan and dealing with its provider and the cost.

Hiring plan providers doesn't get them off the hook

Plan sponsors assume that when it comes to their 401(k) plan, hiring plan providers to carry the load will eliminate the potential liability for sponsoring the Plan. The problem is that whoever they hire, the 401(k) plan sponsor is always going to be on the hook if something goes wrong. Most plan providers are third party providers, exercising no discretionary control so that means the plan sponsor in those situations still gives the final OK for anything done with the plan. Even if a 401(k) plan sponsor hires an ERISA §3(16) administrator and/or ERISA §3(38) investment manager that has discretionary control over the plan's administration and/or fiduciary process, the plan sponsor is still on the hook for hiring them.

It's all about a process and not about a result

When you're in business, it's all about becoming one of the biggest players in the industry. When it comes to 401(k) plans, it's not about being the biggest plan out there or getting the participants to have the best annual rate of return. It's all about having a process in place and following it. When a plan participant directs their own investment in a 401(k) plan, the plan sponsor doesn't need to be concerned with how participants are doing with those investments. What the plan sponsor needs to do is to follow a process that I call the fiduciary process. When dealing with any retirement plan that covers employees, it's important to hire a financial advisor that will help with the fiduciary process. After hiring the financial advisor, an investment policy statement (IPS) needs to be drafted that will serve as the criteria on which investments are selected and when they needed to be replaced. While an IPS isn't legally required, it's a good thing to have as long as it's being followed because an IPS not being followed is worse than not having one at all. After the investment lineup is selected, then the participants need some form of education because ERISA §404(c) requires that plan participants receive enough information to make informed investment decisions. Again, investment education isn't legally required but plan sponsors need to do a lot more than just provide them with Morningstar profiles. Plan sponsors need to understand that liability protection from ERISA §404(c) for losses incurred by participants isn't an all or nothing deal. It's a sliding scale of protection and a good process that's put in place for the fiduciary component of the plan is going to go a long way for protecting plan sponsors from liability from participant losses.

Have an infrastructure in place

Regardless of whether it's called a committee or not there needs to be some sort of infrastructure put in place for making the decisions associated with the 401(k) plan. There needs to be a set infrastructure because any decision maker will be considered a plan fiduciary and eliminates the notion of a lone wolf that makes all of the 401(k) decisions without the authority to do so.

Plan sponsor should only pay reasonable plan expenses - they don't have to be the lowest

A plan sponsor has the fiduciary duty to only pay reasonable plan expenses. Reasonableness is going to be based on the services provided in comparison to what other plan providers charge for similar services in the marketplace. Prior to the age of fee disclosure, plan sponsors had no idea how much the plan was being charged for administrative expenses, which was a Catch 22 when they had to know whether the plan was paying reasonable plan expenses or not. A plan sponsor can't determine whether they are paying reasonable fees by just putting fee disclosures in the back of drawer. A plan sponsor has a fiduciary duty to benchmark the fees being charged to the plan by using a benchmarking service or actually soliciting proposals from other plan providers. Reasonable plan expenses don't mean lowest plan expenses, so a plan sponsor is under no duty to use the cheapest plan providers.

The work of plan providers needs to be reviewed

Too often, the mistakes that plan providers make are only discovered when a plan sponsor changes plan providers and the new one discovers their predecessor's error. What happens if a plan sponsor never changes plan providers? If the plan sponsor never reviews the work of their plan providers, these mistakes tend to only be discovered on an Internal Revenue Service (IRS) and/or Department of Labor (DOL) audit with huge penalties depending on the errors discovered. So plan sponsors would be wise to hire an ERISA attorney such as myself to conduct an annual review. I hate to be so commercial, but I charge a reasonable $750 for these reviews and they can be charged to plan expenses.

Get the proper insurance

While any ERISA covered retirement plan needs an ERISA bond to protect plan assets from the theft of fiduciaries, it offers no protection if plan fiduciaries are sued. While not legally required, fiduciary liability insurance should be purchased to protect fiduciaries especially when they can be personally liable for any damages.

Getting sued is only one threat

For many years, I was told that small to medium sized 401(k) plans never get sued. Of course, a few months back, a small 401(k) plan had to find an attorney after getting sued. While that lawsuit was quickly dropped, it showed that the fear of litigation is reasonable. However, the real threat from most 401(k) plans isn't through litigation, it's through investigation by the IRS and DOL. Over the past few years, the DOL has hired thousands of agents to audit plans and they weren't hired to whistle Dixie. The threat is real and a plan sponsor should never forget that.

THE ROSENBAUM LAW FIRM P.C.

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