The Duties Must Change For 401(k) Plan Sponsors

By Ary Rosenbaum, Esq.

One of the major reasons that I started my law practice was my discontent with the way that mid-sized law firms ran. I think they were the worst-run businesses out there because they didn't have the clientele to support such a huge overhead of fancy offices and large amounts of unnecessary staff. Organizations that are poorly run have a hard time changing because the people that poorly run things, usually don't step aside voluntarily. 401(k) plan sponsors that run a poor plan have to change, they must change. This article reminds us what plan sponsors should do, but probably don't do.

The cycle must change because of the duty

You can't change unless you learn from your mistakes, so that is why so many organizations can't change because they don't learn. I was a Vice President of a struggling synagogue years ago and one of the reasons I quit was because the people making the real decisions were the very same people who ran down membership from 750 families down to 300. Unlike synagogue leaders who can't exit stage right, plan sponsors have a fiduciary duty of prudence to break the cycle of a poorly run plan. When you are responsible for the retirement savings of other people, you have a higher duty of care. The cycle must change because plan sponsors have skin in the game, mistakes they make or the neglect they show, are a problem because of the personal liability that might be involved with the running of the plan.

The structure must change

I had a tough time transitioning from a private day school to a public high school, being very immature at 14 didn't help. I went from a very protective place where teachers looked out for me to a much larger school where the teachers didn't. I needed a structure to succeed and for about 3 ½ years, I didn't. The same goes for running a 401(k) plan. For too many plan sponsors, the only structure is the owner and/or director of human resources handling the plan. A 401(k) plan needs a committee that holds meetings, takes minutes, and keeps good records. Working with a financial advisor who manages the fiduciary process in tandem with a plan sponsor is an important hire. They're an important hire because they are the building block of a prudent fiduciary process. A good financial advisor will help a plan sponsor create the process that will create a committee to run the plan and document the meetings that oversee the plan. When a plan sponsor creates the committee, they have to have an actual operational committee. Having a committee and doing nothing with it is far worse than not having a committee because creating a process and not following it, is a breach of fiduciary duty. The problem with committees besides not having meetings is having too few or too many members. Too few members usually means that nothing gets done, the same can be said of committees with too many members. As Goldilocks might say, the number of committee members has to be just right. In addition, there has to be a commitment to actual work instead of just talking. If the plan has an Investment Policy Statement (IPS) (it really should), it needs to follow the criteria used to select and replace investment options. If the IPS demands the replacement of a mutual fund if it shows up in the red zone to quarters in a row, it needs to be replaced or that could be considered a breach of their fiduciary duty.

Reviewing plan providers has to change

Most plan sponsors never bother reviewing what their plan providers are doing. That's an absolute mistake. Plan sponsors have a fiduciary duty to hire competent providers because they're on the hook for liability if the providers cause unnecessary plan errors. A Third Party Administrator (TPA) will handle the day-to-day administration of the plan, but the liability for those errors belongs to the plan sponsor. To mitigate the chances of errors, a plan sponsor should have their TPA reviewed. It's also important to review the financial advisor to make sure they're doing the job as contracted. I hate surprises and too many plan providers are surprised about the incompetence of their plan provider when there is a government audit or when that plan provider is replaced by another. Nothing worse than finding it takes thousands to fix an error, that might have been less costly to fix if the error was detected soon after it was made. That's why plan providers need to be reviewed for their work.

Reviewing fees has to change

Plan sponsors must pay only reasonable plan expenses for the services provided. Honestly, you will never know if what you're paying someone is charging you is reasonable, unless you find what other companies are charging. Since 2012, plan sponsors are supposed to get fee disclosures from their plan providers as to the direct and indirect payments they receive for working on the plan. Plan sponsors have to pay reasonable fees for the services provided. That means they don't have to pick the cheapest plan providers. They can pay more if they get more from their plan providers. A TPA with an interactive website and an ERISA §3(16) administration service will charge more than one that offers a no-frill service. So a plan sponsor doesn't have to pick the cheapest provider. Most plan sponsors never bother with reviewing their fees and that's an absolute mistake since paying too much will be considered a breach of fiduciary duty. Plan sponsors need to benchmark the fees of their plan providers. They can do it by shopping their plan around with other plan providers. For fee benchmarking, services have to be apples to apples, not apples to oranges. Plan providers offering less in service will charge less, so fee quotes from plan providers should be based on the services they're getting now. A plan sponsor of a small to medium-sized plan doesn't need to shell out thousands for a Request For Proposal (RFP) or hire an ERISA attorney to procure bids. Shelling out $95 for the 401(k) Averages Book and benchmarking fees against what is listed in the book, is sufficient. Any work by a plan sponsor in determining fee reasonableness needs to be documented.

The enrollment/education meeting has to change.

Enrollment and education meetings for newly enrolled and current participants have to take place. Plan sponsors can't be protected under ERISA §404(c) for losses incurred by participants who direct their investments without providing enough information for these participants to make informed investment decisions. An enrollment/education meeting is some time for employees to goof off, it's time to help limit the plan sponsor's liability. It's a time to engage participants, provide information, and help participants improve their retirement outcomes. Working with a good advisor who has helped develop the IPS, help pick and replace investments, and provide investment education, goes a long way.

Record retention has to change

Small and medium-sized plan sponsors need to keep better records. All plan documents and amendments need to be maintained because any missing documents or amendments give inference to the Internal Revenue Service (IRS) that those documents were never created. That's a problem, because a plan that wants to still be qualified, needs to timely amend and restate its document as required by the IRS. Failure to have the required documents and amendments threatens the qualification of the plan, which is costly to fix. In addition, plan sponsors need to keep timely records of committee meetings, enrollment meetings, valuation reports, and distribution paperwork. A retirement plan is like a jigsaw puzzle, you need all the pieces to make it work. In addition, plan sponsors need to make sure that former employees that still have an account balance, still get the necessary notices and investment materials, as required by ERISA.

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