You Have To Deal With Some Unpleasant Facts About Your 401(k) Plan

By Ary Rosenbaum, Esq.

The greatest benefit you can provide as an employer is a qualified retirement plan, such as a 401(k) plan. The problem is that most employers treat a 401(k) plan with as much care as they do with other benefits such as free milk and coffee. The problem is that while sponsoring a 401(k) plan is a great idea, there are some unpleasant facts that go along with it. Unlike Elaine in the movie, Airplane!, you will have to face them as a 401(k) plan sponsor.

You are a fiduciary, whether you like it or not

As a 401(k) plan sponsor, you are also a fiduciary. Being a fiduciary means that you're responsible for the retirement assets of your employees. Being responsible for their money means you need to be more responsible than you are with your own money. You have to provide the highest duty of care and any breach of that duty could result in personal liability. You can always delegate some or all of that duty to a retirement plan provider willing to serve as an ERISA fiduciary, but you can never fully eliminate liability in connection with your plan. Since you can never truly eliminate all the liability associated with a retirement plan, your job is to do your best to minimize it and one of the best ways you can do that is by hiring competent plan providers that can carry some of the load from the heavy lifting you need to complete as a plan sponsor.

You can't do it on your own

As I stated, you need to hire competent plan providers because unless you're in the retirement plan business, you don't have the experience to fully handle it on your own. In addition to hiring a third-party administrator (TPA), you also need a financial advisor to help you with the fiduciary component of the plan. While you may be able to manage your own money, you need help with managing the retirement money of your employees as a plan fiduciary (as discussed above). When needed, you'll also have to hire an ERISA attorney, as well as a plan auditor when your plan requires an annual audit.

Someone else makes a mistake, you're still on the hook

One of the reasons you need to hire competent plan providers is because you'll be on the hook for liability for the errors they cause. The most important plan provider you have to hire is a TPA who would assist you in the day-to-day recordkeeping of your 401(k) plan. The problem with a TPA is their work is labor-intensive and can be prone to mistake. If a mistake is made in the compliance end of your plan, the TPA usually doesn't recognize their error. Instead, it may take many years to find the error, either by a new TPA or on a government audit. Errors detected years later are always more expensive to fix than errors detected soon after they're created. If the errors are serious and detected on a government audit, there is always a possibility of a penalty added to the overall all. Finding good plan providers, especially a TPA goes a long way in making sure there are very few errors. The problem with errors is they run the gamut, small errors that can be easily fixed or very large errors such as failed compliance tests that require thousands of dollars to fix. Another catastrophic error is the failure to file a Form 5500 and there is nothing more unsettling for a 401(k) plan sponsor to get a bill from the Department of Labor (DOL) for over $100,000 for a missing Form 5500. While a plan provider may have an errors and omissions insurance policy to fix an error they made or are willing to make another form of remuneration, the point is that ultimately, you're on the hook for liability. That is why it's important for you to find good plan providers to avoid some of the troubles that come along with plan errors.

The problem with fee disclosures and cost

One of your most important fiduciary duties as a plan sponsor is to make sure that plan expenses are reasonable for the services provided. Thankfully, in 2012, the DOL instituted fee disclosure regulations that allowed required plan providers to disclose the fees they collected and indirectly for their work. That allowed the 401(k) plan sponsor to get a detailed blueprint on the costs associated with the plan. The only problem is that even with this information, too many 401(k) plan sponsors do nothing with these disclosures. As a 401(k) plan sponsor, you have a duty to determine whether the fees the plan is paying are reasonable for the services provided. The only way you can determine reasonableness is by benchmarking your fees with what other providers charge for similar services. One of the biggest issues that I find with costs is that so many 401(k) plan sponsors misinterpret the need to pay reasonable plan expenses into a need to only pay the lowest plan expenses. You have a fiduciary duty to pay reasonable plan expenses, not the lowest. You can pay more if you get more in services from your plan providers. As far as picking the cheapest plan provider (especially in picking a TPA), it's a bad idea if the lowest price was the only factor in hiring them. If you wouldn't hire a doctor or lawyer on cost, don't do it with a plan provider.

The misnomer about no liability for participant-directed investments

For the first 10 years of a 401(k) plan's existence (the 1980s), most plans had investments directed by trustees. Mutual fund companies identified the growing 401(k) industry as a great avenue of distributing their different funds. Thanks to advances in computer technology as well, mutual fund companies pushed the idea of participant direction of investments as a great sales tool for distribution of their funds. In addition, they stressed that 401(k) plan sponsors would not have liability for any losses sustained by a participant through their own 401(k) investments under ERISA §404(c). The problem with ERISA §404(c) that most mutual fund companies and plan providers, glossed over was that 401(k) plan sponsors had a process they needed to complete to actually get that liability protection. The process is a prudent fiduciary process were working with your financial advisor, you develop a method for selection and replacing investment options under the plan. You also have to provide enough information to plan participants so that they can make informed investment decisions. That means providing at the very least, investment education and information about the investment options offered under the plan. What you need to understand about retirement plans is that you have to do your work if you want to limit your liability, you can't afford to be a spectator as it pertains to your own 401(k) plan.

It has to be constantly reviewed

What was good today may not be good a few years from now. Like your children's clothes, your 401(k) plan may no longer fit your needs a few years from now. Your 401(k) plan has to be reviewed to see if it needs to be tinkered to better fit your needs. What was great when your 401(k) plan had 5 employees may not be so good when you have 20 employees. In addition, demographics may change that may require you to develop employer contributions to meet a safe harbor plan design or to maximize contributions to highly compensated employees through a cross-tested allocation. Nothing in your business is static, neither will your 401(k) plan. There are many employee benefits that stand the test of time and require little oversight, a 401(k) plan isn't one of them.

Never lose sight of why you created it in the first place

One of your most important assets is your quality employees and one of the toughest jobs is trying to recruit and retain quality employees. One way you can do that is by paying them well and providing sufficient employee benefits. One way is a well-run 401(k) plan. You should never lose sight of why you created a 401(k) plan in the first place and why you need to be vigilant in making sure things in the plan are well run. As a disgruntled former employee at many jobs, I will say that a good 401(k) plan was a great enticement for me to join and/or stay at a particular job.

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