401(k) Plan Sponsors: Don't Make These Mistakes

By Ary Rosenbaum, Esq.

Larry David is one of my favorite people because he created two of the greatest shows in television history: "Seinfeld" and "Curb Your Enthusiasm." The shows are similar in that they depict bad ideas or bad behaviors. Curb Your Enthusiasm showcases the things that drive Larry David nuts. Plan sponsors do a lot of bad things, and this article is really about things that 401(k) plan sponsors shouldn't do because they're really bad ideas. If plan sponsors proceed with bad ideas and do bad things, there won't be any soup for them.

Not taking their role as plan sponsor as seriously as they need to

401(k) plan sponsors are masters of their domain. They aren't only plan sponsors, but they're also plan fiduciaries. While a retirement plan is an employee benefit like the K-cup machine, plan sponsors have a higher duty of care with that benefit than any other benefit they can offer. That's because as a plan sponsor, they're also plan fiduciaries. That means they have the highest duty of care in equity and in law. Plan sponsors have that higher duty of care because they are responsible for the retirement assets of their employees, and you have a higher duty of care in taking care of someone else's money than they do in handling their own money. All too often, plan sponsors think they can ignore their 401(k) plan or they don't devote sufficient time to it. Unfortunately for them, they can't afford to ignore their 401(k) plan because they have that fiduciary duty that they have to exercise in a prudent manner.

Not reviewing their fee disclosures

As a result of the Department of Labor (DOL) implementing free disclosure regulations about 5 years ago, all 401(k) plan sponsors, where administrative fees are charged against plan assets, are given a disclosure about the fees that they are charging. This is quite different from the old days when plan sponsors had absolutely no idea what fees they were paying for the plan and that was a problem when they had a fiduciary duty to pay only reasonable plan expenses. So the fee disclosure regulations ended the absurdity of plan sponsors not having been told how much the plan expenses were. The only problem was that, as a result of fee disclosures, plan sponsors had absolutely no excuse as to why they were ignorant about the fees that were being charged to the plan. Knowing how much fees are being charged against the plan isn't even enough; 401(k) plan sponsors need to know whether the fees are reasonable for the services provided. Plan sponsors need to understand the fees being charged against the plan for the services provided. Merely taking a peek at the fee disclosures isn't enough; plan sponsors need to benchmark those fees to determine whether they're reasonable for the services provided. Whether plan sponsors seek out pricing from competing plan providers or use a benchmarking service, they have to actually determine whether the fees are reasonable. That doesn't mean they have to find the cheapest providers. Reasonableness is determined by the fees charged for the services provided.

Not reviewing their plan providers

One of the most important concepts that plan sponsors don't understand about their fiduciary responsibility is that they are always on the hook for liability. No matter how much liability that a plan sponsor delegates to its plan providers, the buck will always stop with the plan sponsor. So no matter the error caused by a plan provider, the plan sponsor is going to bear the burden. That's the role of a plan sponsor, to always get the blame if things go wrong even if the problem is caused by a plan provider. That's a problem when most issues with a plan only gets discovered on

a plan audit by the Internal Revenue Service (IRS), or DOL, or upon a change of plan providers. That means errors may get discovered years after they occur, which will increase the cost of correction especially if there are penalties issued under a plan audit. That's why a plan sponsor should always review the work of their plan providers to determine whether they are actually doing a competent job for what they were hired to do. Hiring an ERISA attorney or an independent retirement plan consultant can help minimize any mistakes that a plan provider has caused or may cause. Whether or not errors are discovered, a plan sponsor needs to exercise their fiduciary duty by reviewing their plan providers to make sure they're doing their job in a competent fashion that doesn't put the plan at risk. Plan sponsors don't have to make sure that plan providers are sponge worthy, but they're just worthy as plan providers.

Hiring friends or family as plan providers

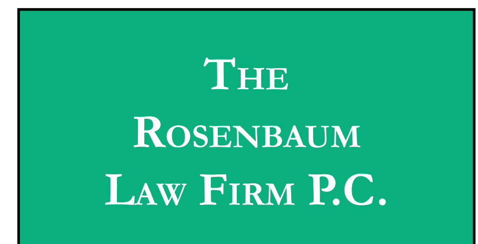
Hiring and/or retaining plan providers should be conducted through a fair and reasonable process. That means hiring the best available providers for a plan based on size, complexity, and reasonableness of fees. There will no feats of strength or airing of grievances. That means hiring plan providers for what they know and not who they know. There is nothing wrong with nepotism if you're dealing with the hiring in a family-run business, but there is no place for nepotism in the hiring of plan providers. In certain situations, hiring a plan provider could be a prohibited transaction that can put the plan at risk for penalty. In most situations, plan providers breach their fiduciary duty when they don't bother to go through an actual process of selecting providers and instead simply hire someone because they're related to someone involved with the plan, or because of the relationship between the provider and the plan sponsor such as hiring the bank as a financial advisor because they give the plan sponsor a line of credit. A retirement plan is for the exclusive benefit of plan participants, so hiring a plan provider based on nepotism or cronyism will inevitably invite the question of whether plan sponsors are actually providing that exclusive benefit and not doing what's best for them. Selecting a plan provider based on nepotism or cronyism is an unwise and ill-advised decision..

Not understanding participant direction of investments

The idea in offering a 401(k) plan that offers participant direction of investments isn't because plan sponsors love freedom of choice. The reason they opt for 401(k) plans where participants direct their own investments is because they were told that they wouldn't be liable for any losses incurred by participants who get to choose their own investments. The only problem with that is that they don't understand what they have to do to achieve that limit on liability that is offered for what we call ERISA §404(c) plans. In order to get that liability protection, there is some work to be done on the plan sponsor's end. The plan sponsor needs to offer a menu of investment options and those options need to be prudently selected. That means that the plan sponsor has to sit down with their financial advisor and select and replace investment options on set criteria and to actually follow those criteria on a timely basis. That also means providing investment education to plan participants so that they can make informed investment decisions. By selecting investments in a prudent manner and offering education to plan participants, a plan sponsor can expect to achieve some level of liability protection.

Not understanding what a good TPA does

It's not enough that a plan sponsor hires a TPA; they need to hire a good TPA. Why is that? Based on the work they do, the TPA is the most important plan provider that a plan sponsor hires. They're the most important plan provider because they do the most amount of work and so that means they would cause most of the errors and headaches that could land a plan sponsor in trouble. A good TPA makes few errors and when they do make the error, they discover them in a timely fashion. A good TPA is also a master of plan design that can help a plan sponsor maximize the use of employer contributions for their own tax deduction benefit and to reward their highly compensated employees. Hiring a TPA just because they're cheap or just because they also handle a payroll are always bad ideas. Plan sponsors need to hire a competent TPA to avoid the many compliance headaches that occur with incompetent plan providers.



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