Routine Mistakes That 401(k) Plan Sponsors Aren't Aware Of

By Ary Rosenbaum, Esq.

They often say that the road to hell is paved with good intentions. Like I always say, whoever made that quote up must have been a 401(k) plan sponsor. The problem with being a plan fiduciary is the liability that goes with the position and another major problem is that the plan sponsor may not be aware that some of their decisions are big mistakes that are going to cause problems down the line. So this article is routine mistakes that a plan sponsor isn't aware of.

Putting one person in charge of the retirement plan

Many small and medium sized businesses only have one person over there working on their retirement plan. While most businesses aren't larger enough to afford to put more than one person in charge, it's really a recipe for disaster. Having one person is in charge isn't going to work out because it's only one set of eyes. The first thing that's an issue is what I call the hit by a bus argument first made by Marge Tracey, a paralegal who probably told me everything I know about retirement plans. The hit by the bus argument means that if there is one person dealing with a situation it's important that someone else knows what's going on in the event that a bus hits the one person in charge. It might be crass to say that, but there is danger in having only one person in charge especially when that person does leave because they change jobs, dies, are disabled or retired. It's also a problem because the one person in charge of the plan may not see many issues that are problematic for the plan. I always use my old law firm's 401(k) plan as how not to do things. While there were two trustees of the plan, the human resources (HR) director was the person in charge. When I was asked to review the plan, there was no investment advisor on the plan; plan investments weren't reviewed for 10 years; and no investment

education was provided to employees. Of course when I suggested about 3 investment advisors to interview for the job, the HR director knew best and selected someone else. I wasn't even alerted when a bundled insurance company plan provider was hired as the new third party administrator (TPA), I wasn't consulted about that either. So for the past six years I've been in my own practice, I often cite that law firm example. It's got me dirty looks from her the time I saw her in the elevator when I got my allergy shots (my old law firm and my allergist are in the same building) and it cost me business when they were looking for an ERISA attorney to alleviate a major error caused by that insurance provider. So I understand the issues and problems that result when a company only has one person in charge. That's why a committee of an odd number of company representatives should be appointed to oversee the 401(k) plan and document the decision making process of the plan. More eyeballs looking at the plans means that there are no scary secrets when one decision maker of the plan leaves the company on their own terms or someone else's. It's certainly important to have one person in charge, but there needs to be a system of checks and balances to insure that the needs of the plan and plan participants aren't being ignored.

Not reviewing the plan on an annual basis

Did you ever hear a story about someone who was feeling ill and their doctor told them it was nothing and they later got a grim Cancer diagnosis because their doctor did nothing a few months back? When we take care of our health issues, we're often advised to seek a second medical opinion when something seems to be wrong. When it comes to retirement plans, retirement plan sponsors never seek a second opinion on how well or not well their retirement plan is doing. It's

a problem when the plan only uses the same TPA because errors only seem to be discovered when there is a change of TPA. The problem is that these errors could threaten the continued tax qualification of the retirement plan. I often tell the story of a retirement plan sponsor who was sued for $3 million by the Department of Labor (DOL) because the DOL assumed wrongly that the owner of the company embezzled money from the retirement plan because of bad advice from the TPA and the TPA never bothered to do a proper valuation of the plan for 25+ years to determine what the owner's benefit really was so the DOL had no other choice to assume embezzlement when distribution checks to the owner were made out payable to their other businesses. When I started my practice 6 years ago, I developed a plan review called The Retirement Plan Tune-Up that was only $750. Despite the very reasonable fee and the review that went with it, I could probably count on two hands how many reviews I've done. Plan sponsors don't want to pay that fee eve if it can be paid from plan assets because like a villain in a spy movie, they assume everything went to plan. Part of me also assumes that like people who don't want to see the doctor, plan sponsors don't want to know the truth about the bad shape that their plan is. If they ignore it, they think that it will go away. Plan errors never go away, then just get bigger if not tended to just like a tumor.

Not being concerned about appearances

Just being correct, doesn't make it right if it looks bad. Does that make sense? I think that it does because all I'm saying is that if things don't look right; it leads to the suggestion that something is wrong even if it isn't. It's like cronyism and nepotism, it leads to the suggestion that something improper was done by hiring a friend or relative as a plan provider. It might not be a prohibited transaction to hire your cousin as a retirement plan provider, but it gives the impression that the selection of plan providers wasn't made on a decision that was best for plan participants. Even selecting a bundled retirement plan provider and only using their proprietary mutual funds gives a bad appearance because it implies that there was a quid pro quo in using proprietary funds to get better pricing on plan administration. Selecting mutual funds that pay revenue sharing also gives a bad appearance; it implies that plan investments were selected mainly because they paid revenue sharing to defray plan expenses. Like that old British comedy shown on PBS, it's all about Keeping Up Appearances. Things that don't look right may give ERISA litigators and government agents the impression that things aren't right. It's not just about a retirement plan being in compliance, it's also about making sure that the retirement plan looks like it's in compliance too.

Not understanding and valuing what a TPA does

With apologies to fellow ERISA attorneys, auditors, and financial advisors, the most important retirement plan provider is the TPA. The TPA does the bulk of the work in keeping a plan in compliance; they get little of the credit for their good work, and get all of the complaints when something goes bad. They are the most important plan provider because their good work or bad work will keep a plan in compliance or given the plan sponsor a huge financial headache. So it's amazing how little concern that a plan sponsor has in hiring a TPA. How else can you fathom that the two biggest TPAs are payroll companies who know very little in plan design and compliance testing? A plan sponsor needs to understand the tasks that a TPA does on a daily basis when it comes to working on a daily valued, participant directed 401(k) plan. A TPA does so many things like trades, reconciliation, deposit of contributions, compliance testing, and preparation of Form 5500 that things could go wrong. So the difference between hiring a good TPA and a bad TPA is that there are less errors and headaches with good TPAs. A plan sponsor shouldn't hire a TPA because they also do payroll or because they are the cheapest, pick the TPA that charges a reasonable fee for good, solid work that will keep the plan in compliance.

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