Tedious Tasks That 401(k) Plan Sponsors Need To Complete

By Ary Rosenbaum, Esq.

In life, there are certain tedious tasks that we want to avoid doing. For me, it's usually cleaning the bathroom or changing the bedroom sheets. The problem for a 401(k) plan sponsor is that despite how tedious some tasks are, they are unavoidable because (sounding like a broken record) plan sponsors have a fiduciary duty in managing their 401(k) plan. While some tasks of being a plan sponsor are tedious, they are all required tasks and failure to complete a task can cause a whole host of problems and money to fix these tasks. This article is about tedious tasks that plan sponsors need to make sure are done and done correctly.

Tracking eligibility

Every retirement plan has eligibility requirements that an employee must complete in order to be a plan participant. Some 401(k) plans have immediate eligibility, some require 1,000 hours within a year of employment. Regardless of the eligibility, plan sponsors need to make sure that eligibility requirements are tracked to make sure that employees became participants when the plan documents say they can become a participant. It's important for plan sponsors to make sure that plan operation is done according to the plan document terms. In addition, failure to include eligible employees as plan participants may require the employer to make corrective employer contributions (plus earnings) whether they're for employer contributions or what is known as a missed deferral opportunity. Failure to include eligible employees as participants over time may require the plan sponsor to fork over a corrective contribution for the time that these employees didn't have the opportunity to make deferral contributions. The problem is that these corrective contributions must be made to all affected employees whether they were planning to make salary deferral contributions or not. While a major responsibility of a third-party administrator (TPA) is to track eligibility, many errors occur because of non-reporting by the plan sponsors. If the 401(k) plan sponsor tracks eligibility on their side correctly, it eliminates the potential for errors that may cost them money in terms of corrective contributions.

Depositing salary deferrals timely

A 401(k) plan is a profit-sharing plan with a cash or deferred arrangement (CODA). The hallmark of a CODA plan is the use of the plan by participants to defer taxes on their salary deferral/elective contributions. One of the consistent tasks of a 401(k) plan sponsor is to deposit these salary deferral/elective contributions into the plan. The task not only must be done, but it must also be done as soon as possible. For years, plan providers and 401(k) plan sponsors relied on regulations that gave plan sponsors a safe harbor as long as they deposited the deferrals no later than the 15th day of the following month. A few years back, the Department of Labor (DOL) said that reliance was incorrect, salary deferral contributions must be made as soon as possible. The DOL has scaled up their enforcement of timely salary deferral deposits by creating a question on Form 5500 to ask a plan sponsor if there are any late deposits. They have also instituted a voluntary compliance program that allows plan sponsors to fix late deposits with no penalty. That means the DOL is concentrated on cracking down on plan sponsors making late deposits of salary deferrals through audits and they use that Form 5500 question as fodder for which plan sponsors to target Depositing salary deferrals into a 401(k) plan is a tedious task, but deposing deferrals late is one of the most avoidable plan errors, yet it's the most frequent. I understand the DOL's insistence that deferrals be deposited as soon as possible, to avoid the idea that a plan sponsor can use salary deferral deposits as some kind of checkbook "float" to pay off other bills. There is no reason why salary deferrals can't be made within 3 business days, especially with online banking. While plan sponsors with multiple locations have a tougher time than those with a single location, it's incumbent on the staff to make sure deposits are made timely. If they aren't, then the plan sponsor should identify the late deposits and fix them as early as possible instead of letting their accountants (if the plan has a required audit) or the government (IRS/DOL) discover it.

Keeping copies of all plan documents

While 401(k) plan sponsors are often told that they should keep records for ERISA for 7 years, keeping plan documents and amendments is forever. Every few years, the Internal Revenue Service (IRS) requires plan sponsors to amend or completely restate their plan document. When the plan is being audited by the IRS or is seeking a favorable determination letter, the plan sponsor is often required to present their older plan documents and amendments (that may no longer be even in effect) to make sure that the plan sponsor complied with the IRS set deadlines to amend or restate their plan document. I have often had to represent plan sponsors before the IRS who probably did amend the plan document as required, but didn't have a copy of the executed amendment and/or restatement. The problem with not producing a copy of a fully dated and executed amendment/restatement is that the IRS treats the plan sponsor as if they never completed it. Every plan document and plan amendment should be stored and saved for the inevitable future use.

Handing out notices and SPDs

ERISA is all about protecting participant rights and there is a requirement to hand out certain annual notices as well as the summary plan description when an employee becomes a participant and when there has been a plan document restatement. It's important that a plan sponsor can complete this task because not handing out something required such as an annual safe harbor notice can have drastic effects (such as the disallowance of the plan being safe harbor) or penalties.

Review fee disclosures

401(k) plan sponsors get disclosures from their plan providers on the direct and indirect compensation they receive for servicing the 401(k) plan. The problem with the disclosures is that plan sponsors need to review them and benchmark their fees because they have a fiduciary duty to pay reasonable plan expenses. Putting the disclosures in the garbage or the back of the drawer won't allow 401(k) plan sponsors to determine whether the fees are reasonable or not. A 401(k) plan sponsor has to be diligent with this tedious task by shopping the plan around to competing plan providers or by benchmarking fees through a service or book. Regardless of the method, a 401(k) plan sponsor has to be active in determining whether plan fees are reasonable or not.

Substantiating hardships for distributions

Hardship distributions are a popular feature for most 401(k) plans because they allow the participant to withdraw from their plan for a hardship reason, which typically falls under the IRS' safe harbor guidelines, such as for medical expenses, funeral expenses, and to prevent eviction/foreclosure. The major problem with hardship distributions is that most plan sponsors don't review whether participants document that financial needs. Whether it's an eviction notice or a hospital bill, plan sponsors can't take a participant's word that they qualify. The IRS is ramping up the review of hardship requests as part of their audit.

Making sure participant loans are paid

Like hardships, loans are popular as participants can use loan proceeds from their account balance and pay it off. A headache with loans is that they need to be on a payment schedule, at least quarterly, to avoid a default. For many reasons such as multiple loans or a participant not working, plan loans may inadvertently fall into default and that would cause a taxable deemed distribution to plan participants. If the loan isn't treated as a default, the 401(k) plan is treated as committing a prohibited transaction as it doesn't meet the loan exemption for prohibited transactions.

Comply with ERISA §404 (c)

Too many plan sponsors think they're bulletproof from liability for losses sustained by participants who direct their own 401(k) investments. They don't understand that ERISA §404(c) will only protect plan sponsors from this liability if they take part in a process of prudently selecting plan investments and giving plan sponsors enough information to make informed investment decisions. That means plan sponsors must review plan investment options with their advisor and they must provide at least investment education to participants on a regular basis. This liability protection isn't all or nothing, the protection depends on how much of the process that the plan sponsor fulfills.

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