401(k) Options That Must Be Obligatory For Plan Sponsors

By Ary Rosenbaum, Esq.

Buying a car isn't easy because it's confusing with the different option packages and trims. Sometimes I jokingly ask whether a steering wheel comes standard or whether it's an option for a more expensive package. For a 401(k) plan sponsor, there are a lot of options out there and while some features are options, it's my opinions that some options need to be obligatory. So this article is 401(k) plan options that need to be compulsory for plan sponsors to select.

Hiring a TPA

Yes, hiring a third party administrator (TPA) isn't legally required. However, if a plan sponsor has no background in retirement plans, it's pretty much obligatory. There are some employers who are either in the administration business or there are large Taft-Hartley plans that can handle their own administration. Otherwise, a plan sponsor needs to hire a TPA to handle the day to day administration of their 401(k) plan. Not only do they have to hire a TPA, but they also have to hire a good one because of the many tasks that if done incorrectly, could put the plan sponsor in a very precarious spot where they're subject to liability for compliance errors and omissions.

Hiring a financial advisor

While people can invest their own money on their own, plan sponsors are making a huge mistake by thinking they don't need a financial advisor. Picking mutual funds for personal investment is one thing, but managing the fiduciary process is quite another. Plan sponsors need to understand that they're fiduciaries, they have a higher duty of care. That means they need to be responsible for the retirement assets of their employees than they are for investing their own money. While most educated people probably could pick a decent lineup of mutual funds as an investment lineup for a 401(k) plan, that is just a small part of what advisors do. A 401(k) plan needs an advisor to help manage the fiduciary process of a participant-directed plan. Too many 401(k) plan sponsors think that if participants can direct their own investments, then they are protected from liability for the losses sustained by the participants. That's actually an incorrect reading of what a participant-directed ERISA §404(c) plan is all about. A plan sponsor only gets protection for an ERISA §404(c) plan by going through a process of prudent investment selection and giving plan sponsors enough information that they can make informed investment decisions. The protection offered under ERISA §404(c) isn't all or nothing, it's a sliding scale based on how much a plan sponsor is willing to comply with the fiduciary process. Again, that's why an investment advisor is needed and that's whether they're a broker or a registered investment advisor serving in a fiduciary role. So while hiring a 401(k) financial advisor isn't actually required, no plan sponsor with employees should think they can actually manage their plan correctly without an advisor attached to it.

An investment policy statement (IPS)

Advisors talk about the need for a plan sponsor to have an IPS and I'm sure most plan sponsors and even advisors don't understand that there is no legal requirement for an IPS to be implemented. It doesn't

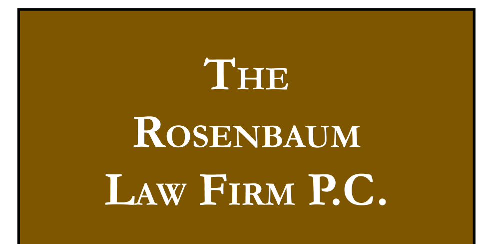
say it in ERISA §404(c), the regulations, or anywhere else that it's legally required. Just because it's not legally required, doesn't mean a plan sponsor shouldn't implement one. An IPS is the document that set forth the criteria of how investments are selected and/or replaced for the 401(k) plan. An IPS is merely a blueprint and it's an indication that the plan sponsor intended to follow a rational and prudent process in investment selection. The problem with the IPS being a blueprint is that it needs to be followed. I will always argue that a 401(k) plan that doesn't have an IPS is in a far better standing than a plan that does and doesn't follow. Why? Having an IPS and not following it is a breach of the fiduciary process that the plan sponsor put in place. Like a diet that you don't follow, an IPS that a plan sponsor doesn't follow is meaningless. Unlike a diet, an IPS not followed can cause some liability to the plan sponsor. So an IPS needs to be followed and one of the great ways to do that is by how it's drafted. An IPS is better if it's drafted in a loose manner where it doesn't force the plan sponsor to ask. For example, an IPS that forces a plan sponsor to change an investment because it hit the red zone or two quarters in yellow forces the plan sponsor to act. A failure to act by replacing the investment is a breach of the process. So I always say that 401(k) advisors should offer a loose IPS that while sets the criteria, gives another leeway for the plan sponsor to act or not act, depending on the situation. A plan shouldn't be backed into a corner that forces their hand if they actually don't follow what they set forth in the IPS. So while an IPS isn't legally required, any sensible 401(k) plan sponsor will see that it really needs to be obligatory. Again, to beat a dead horse, the IPS needs to be elastic and it needs to be followed.

Offering education and/or advice to plan participants

Again, as part of the fiduciary process for a participant-directed plan, a plan sponsor needs to be proactive to comply with ERISA §404(c). One large component of the process to limit a plan sponsor's liability under ERISA §404(c) is to provide enough information to participants in order for them to make informed investment decisions. At my old law firm, the human resources director thought at the time that it meant giving the plan participants some Morningstar profiles and a summary plan description. Giving plan participants enough information is similar to proving them investment education on basic investment concepts. Education is on common investment concepts, it is not specific advice on how plan participants should invest based on their current situation and retirement goals. Thanks to a clear need to help participants, the Department of Labor over the past 5 years have loosened the investment advice rules. Investment advice is specific advice based on the investment options in the plan, the current situation of the specific plan participant, and the retirement goals of the participant. Studies have shown that plan participants who get investment advice have better investment gains than those who don't. Not all investment advisors offer investment advice and a broker who don't receive a consistent leveled fee can't offer it. At the very least, investment education must be offered to all plan participants in order to help a plan sponsor limit their liability under ERISA §404(c). If possible, investment advice should be offered to plan participants if available from the advisor or if the plan sponsor wants to hire a provider that will offer it.

Fiduciary Liability Insurance

Many 401(k) plan sponsors don't understand that fiduciary liability insurance is a distinct concept from an ERISA bond. While all plans that are covered under ERISA must have a fidelity bond, there is no legal requirement that a plan purchase liability insurance to protect plan fiduciaries. ERISA requires that every plan fiduciary and every person who handles plan funds be bonded. These bonds cover the plan from loss of assets due to fraud or dishonesty. The ERISA bond is required to protect the participants and beneficiaries from dishonest acts of a fiduciary who handles plan assets. Fiduciary liability insurance protects plan fiduciaries against claims alleging that they mismanaged an employee benefit plan or plan assets. This includes, but is not limited to, making bad investment decisions, negligently handling plan records, and negligently selecting plan service providers. In addition to being an effective risk transfer tool for companies, these policies are a vital means of protecting fiduciaries' personal assets since ERISA §409 imposes personal liability on plan fiduciaries who breach their fiduciary duties. This means that fiduciaries might have to personally pay for any losses they cause out of their own private assets. No fiduciary would want to expose their participants in their role in managing their 401(k) plan, so that is why plan sponsors should buy fiduciary liability insurance and not consider it an option that they could ignore.



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