Classic 401(k) Plan Sponsors Mistakes That Leads To Costly Fixes

By Ary Rosenbaum, Esq.

What makes a classic? Whether it's a 1963 Chevrolet Corvette or the Sgt Pepper album, it usually means that it's the highest in quality, class, or rank. So it's kind of funny that there are 401(k) plan sponsor mistakes that are actual classics because these mistakes are usually the mistakes that lead a plan sponsor into a whole host of trouble and liability. So this article is about classic 401(k) plan mistakes that you need to avoid in running your plan.

Not having a financial advisor or having one that is MIA

I'm still amazed how many 401(k) plans out there don't have a financial advisor or if they do, have one that is missing in action but is still collecting a quarterly fee. The point of having a financial advisor on the plan isn't really to pick funds, it's all about liability protection. While anyone can pick a mutual fund lineup if they have some basic financial education, what a good 401(k) financial advisor does is a lot more than that. A good 401(k) advisor helps a plan sponsor limit their liability protection to make sure they comply with ERISA Section 404(c). Too many plan sponsors assume incorrectly that as long as they offer participants the right to pick their own investments, they're going to be held harmless for any investment losses form the participants. That's not true as ERISA Section 404(c) protection isn't a blanket liability policy. ERISA Section 404(c) requires plan sponsors to be vigilant in monitoring plan investments and to provide enough information to plan participants to make informed investment decisions. So my old law firm where they didn't have an advisor, didn't update their fund lineup in 10 years and didn't provide any relevant information to plan participants would have been fully liable for any participant investment losses until I advised them to fix things. ERISA Section 404(c) is a sliding scale of liability protection, the more that plan sponsors fulfill their fiduciary duty, the more protection they'll get. A good 401(k) financial advisor will help plan sponsors develop an investment policy statement (IPS) that will articulate the methods how investments are picked and/or replaced, they will monitor investments according to the IPS, and they will provide investment education to participants. As far as 401(k) plans with advisors who never visit them

or contacts them, they're in a worse spot than plans that don't have a financial advisor. Why? Well, the advisor who doesn't show up and does their job is offering the same level of protection to a plan if they didn't have an advisor (zero protection) and they're collecting a fee for it. I'll never forget the Retirement Plan Tune-Up (that legal plan review that I do for $750) for a plan where they were paying an advisor 60 basis points on a $14 million plan who didn't do anything for the plan. After my review, the plan hired an advisor who was helping them out for only 25 basis points and doing the work. It's not hard to suggest that a plan sponsor is breaching their fiduciary duty by paying an advisor and not getting any work product in return. As far as helping a plan sponsor manage the fiduciary process, a 401(k) plan advisor also helps out by serving as an ombudsman for the plan as well as serving as a check and balance on other providers such as the third party administrator (TPA). So not having an advisor or having one who belongs on a milk carton because they're missing from their job, this is a classic mistake that land 401(k) plan sponsors in trouble.

Not reviewing their providers and their fees

Like a villain in a James Bond or Austin Powers film, a 401(k) plan sponsor can't afford to assume that everything goes to plan. As plan fiduciaries, a plan sponsor must exercise the highest duty of care because they're handling the retirement assets of their employees. While working with plan providers, a 401(k) sponsor needs to understand that no matter what, they're on the hook for liability for what the provider does or not does. There is nothing worse than for a 401(k) sponsor to assume that everything their provider is doing correctly and the only way they can find out the truth is when they replace that provider or something is wrong and caught on an Internal Revenue Service (IRS) or Department of Labor (DOL) audit. When that happens, it's going to be too late to fix without it costing a plan sponsor a lot in corrections and/or penalties. So a 401(k0 sponsor needs to review the work that their providers are

doing by consulting with outside retirement plan professionals. In addition, a 401(k) plan sponsor has a fiduciary duty to only pay reasonable plan expenses and the only way they can determine that is by reviewing the fee disclosures they receive from their plan providers and benchmarking those fees by shopping the plan around. Loyalty is a great trait, but blind loyalty isn't. A 401(k) plan sponsor can be loyal to a sponsor that is doing a great job and charging a reasonable fee as long as they're verifying it. If they're not, that's blind loyalty and I know of too many plan sponsors that have used providers for well over a decade and get the rude shock that the loyalty was misplaced because the providers weren't doing their job. Not reviewing their plan providers and the fees they charge is a classic mistake that 401(k) plan sponsors make.

Not having multiple people responsible for the plan

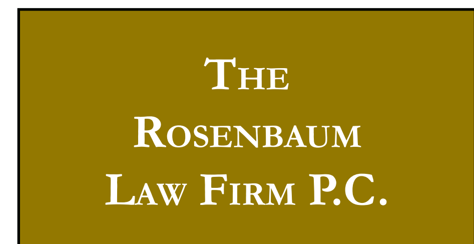
When I first started working as a lawyer associated with a TPA around 20 years ago, I was always told that I should take notes of what I'm doing in case I would get hit by a bus. They weren't trying to put a curse on me or suggest that my time on this earth was going to be a lot limited; it was to make sure that if I was unable to finish my work, someone else would. One classic mistake that a 401(k) plan sponsor makes is when they only have one person at their office in charge of the plan. The reason that it's a mistake is that it's not a good idea to put all their eggs in one basket. It's wise for a handful of people to be in charge of the 401(k) plan because it places a system of checks and balances to make sure that what needs to be done for the plan is being done. I've seen too many plan sponsors needing to fix plan errors because they found out that the person in charge of the plan who is no longer there might not have done what they were supposed to do, such as depositing salary deferrals into the plan on a timely basis. By having a committee of the 401(k) plan sponsor's decision makers run the plan will go a long way to making sure there aren't any glaring omissions than if they just had one person in charge of the plan.

Not reviewing the terms of the plan to make sure it's the right fit and are correct

A 401(k) plan is governed by the terms of the plan document. A plan sponsor also has to make sure that their plan document is updated when the IRS says they have to. Not only does a plan sponsor need to update their plan documents when the law requires it, they also need to make sure that the plan documents are consistent with what they do in practice. There are way too many plan sponsors that administer their plan one way and their plan document may say something else. That's a problem because a plan sponsor has to administer their plan according to their plan document's terms. For example, the plan sponsor may exclude some parts of compensation for making employer contributions even though the plan document requires it. There is nothing worse than sticker stock when a plan sponsor discovers they owe contributions they never intended to make because their plan document says they have to. A 401(k) plan sponsor that doesn't make sure their plan document is consistent with the administration of the plan is making a costly, classic mistake that will catch up with them eventually and will be costly. Another classic mistake for the 401(k) sponsor is not making sure the terms of the plan still fit their needs. A plan that consistently fails their discrimination testing may need a safe harbor contribution formula added. A company that is flush with cash may be wasting money by not implementing a cross tested/new comparability allocation that will increase contributions for the highly compensated employees and increase their tax deductions. Whether it's to make sure it's consistent with their administration and consistent with their needs, a 401(k) plan sponsor needs to review their plan document.

Not having the right insurance

All 401(k) plans that are covered under ERISA must have a fidelity bond to protect against theft by plan fiduciaries. If they don't have the required bonding and they acknowledge it on their Form 5500, a plan sponsor will usually be targeted by the IRS and/or the DOL for a plan audit which can be costly whether the auditor discovers a problem with the plan or not. In addition, it's a problem not having a bond when a fiduciary does steal money from the plan like the time I represented a plan sponsor who was ripped off by Bernie Madoff. While a fidelity bond is required, fiduciary liability insurance is not. Litigation can cost a lot of money even if a plan sponsor wins a lawsuit, so it's a classic and costly mistake for a plan sponsor not have fiduciary liability insurance if they get sued.



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