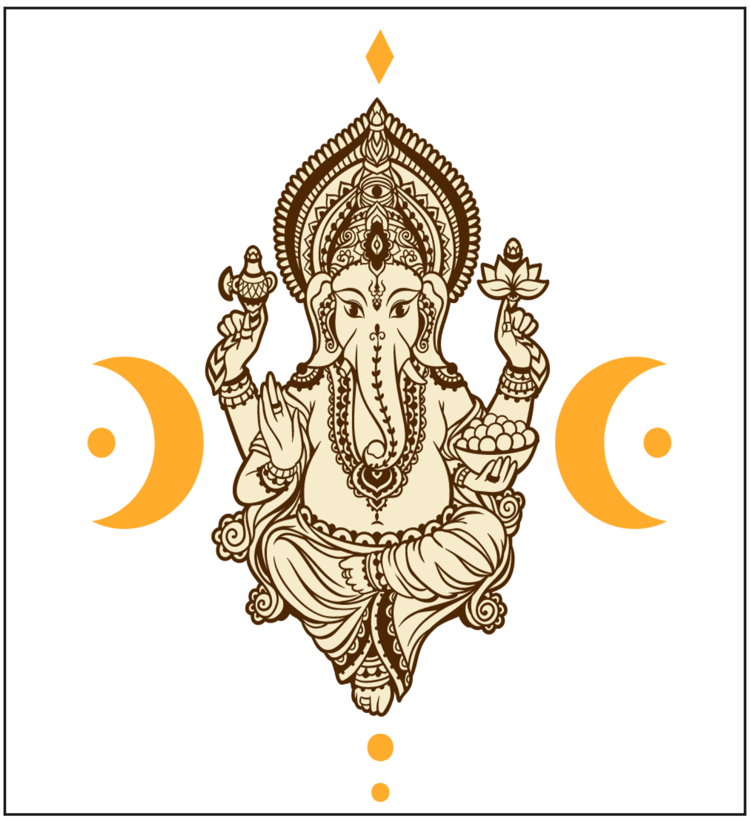
"Mantras" That Will Keep 401(k) Plan Sponsors Out Of Trouble

By Ary Rosenbaum, Esq.

I don't believe in luck and I don't believe in fate. I believe our lives are mostly driven by the choices we make. Many of my successes and many of my failures have led me to where I am now. My grandmother, Rose, was the greatest person I knew. Her life was shaped by her experiences including nearly dying at Auschwitz, she lived an exemplary life, guided by simple principles. She knew things about people, by observations and her simple ideas of what was right and what was wrong. One of these days, I will finish a book of mantras and sayings, that have guided me to where I am in life. There are mantras that you, as a 401(k) plan sponsor can follow and lead you from a path that will cost you in fiduciary liability. This is what this article is all about.



"You're a fiduciary, you can minimize your liability, but you can never fully eliminate it"

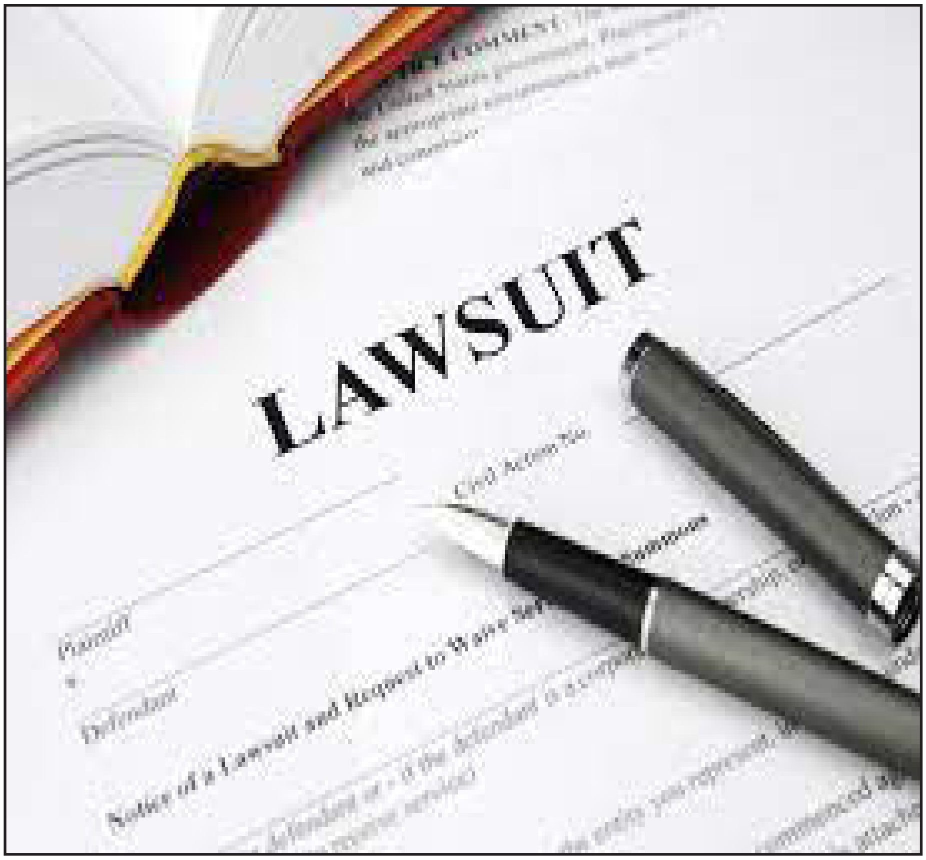
As a 401(k) plan sponsor, you wear multiple hats. As an individual, you can be a plan sponsor and a trustee. More importantly, you are a plan fiduciary. Being a plan fiduciary, means you are responsible for the retirement savings of your employees. That means you have the highest duty in law and equity. If you are irresponsible with your money, that's on you. However, you're liable if you are irresponsible over the retirement assets of your employees. You can minimize your fiduciary liability through good practices, but you can never fully eliminate it. So if a plan provider is claiming they can eliminate all your fiduciary liability, they're not telling you the whole truth. Yes, you can delegate your fiduciary liability to a plan provider such as a financial advisor serving in an ERISA §3(38) capacity or hiring a provider to serve as an administrator in a §3(16), but you're still responsible for hiring. Even joining a Pooled Employer Plan (PEP) may eliminate your liability in the day-to-day running of the plan, but you're still responsible for selecting which PEP to join and a bad choice puts you at risk of potential liability. Taking your role as 401(k) plan sponsor seriously and diligently, while hiring good plan providers will help minimize your liability.

"Remember that a 401(k) plan is an employee benefit"

Too many 401(k) plan sponsors have forgotten why they set up their retirement plans. In a nutshell, a 401(k) plan is an employee benefit. An employee benefit is to recruit and retain employees. I was an employee once (a few too many times over a 12-year period) and a 401(k) plan was a recruitment tool. Since my wife worked for a local government when I was an employee, medical insurance was of no concern. For me, the eligibility period, any employer contributions, and a vesting schedule could be plusses or minuses when considering employment. While I speak badly about the previous law firm, the immediate eligibility and 5% employer contribution that was fully vested, were great recruiting tools that did exist (they lied about bonuses). If you neglect the plan you set up, it can certainly expose you to fiduciary liability. If you treat the 401(k) plan as a forgotten relative, your employees will notice. I worked at a third-party administration (TPA) where our 401(k) plan shifted platforms to an insurance company-based product to preserve pricing for our clients, that didn't sit well with me or the employees who didn't have the big mouth I had (I was a malcontent). It's hard to find good employees and it can be harder to keep them, a good 401(k) plan will go a long way.

"You shouldn't go into business for yourself with your 401(k) plan"

A 401(k) plan is for the exclusive benefit of your employee. It is not a tool for you to go into business for yourself. Kicking the advisory work on your 401(k) plan to a firm affiliated with the bank giving you a line of credit is going into business for yourself. The same is true if you hire your cousin as the plan's advisor. I live in a village where the powers that be, that control the school district, sanitation district, and library, dole out jobs to friends and family. As a fiduciary, you can't go into business for yourself. Some transactions you want might be prohibited and some just look improper. So just remember, your 401(k) plan is for your employees, and not to enrich yourself.



"A government auditor is a bigger threat than any 401(k) lawsuit"

I have been in this 401(k) business for 25 years and plan sponsors are a lot smarter than they were 25 years ago. One big reason is the Internet. Despite the social media nonsense, the Internet represents information at your fingertips. Information you used to spend hours at the library doing research can be found in seconds. Thanks to fee disclosure regulations and information about 401(k) litigation and issues, plan sponsors are more knowledgeable. As far as 401(k) plan litigation, if you have a small or a medium-sized plan, the risk of being sued is very minimal. ERISA litigators front lawsuit costs and get a slice of 33 1/3 to 40% in damages. If you have a $1 or $10 million plan, there isn't much of a settlement for them to bother with you. The real threat as a 401(k) plan sponsor comes from Internal Revenue Service (IRS) and Department of Labor (DOL) agents that might audit your plan. An audit could come as a result of a participant complaint, or an error on your tax returns (for the plan or business tax returns), but usually, it's random. I have worked on audits of all kinds and some that almost lasted a year. There are many good IRS and DOL agents who find costly plan errors where plan providers haven't discovered them. Plan errors can be catastrophic for a 401(k) plan and costly for you to clean up. There are some bad IRS and DOL agents who will prolong an audit for months and months without discovering any real issues, which could cost you. Again, these are the reasons that I fear a government audit than a 401(k) lawsuit.

"ERISA §404(c) isn't a suicide pact"

When 401(k) plans started, the investments were directed by trustees. Thanks to breakthroughs in technology and mutual fund companies' marketing, there was a big push in the 1990s for participants to direct their own investments. The idea was that under ERISA §404(c), a plan sponsor would be held harmless from liability for losses incurred by participants who direct their own investment. The problem with the idea is that ERISA §404(c) isn't some sort of suicide pact, where a plan sponsor is held harmless no matter what. ERISA §404(c) is really a sliding scale when it comes to limiting your liability. As a plan sponsor, you need to provide participants with enough information to make informed investment decisions. Then, you can eliminate the potential liability from participant losses. That means you need to hire a financial advisor who will help you manage the plan's fiduciary process in a prudent manner. That means developing an Investment Policy Statement (IPS) to determine when to select and replace plan investments, following the IPS, and providing investment education to participants. When my old law firm didn't have an advisor and didn't replace the mutual fund investments in the 401(k) plan for 10 years, I warned them that their protection under ERISA §404(c) was going to be nothing. If you're going to offer participants a chance to direct their investments, you might as well get the liability protection that should go along with it.

"You get what you give, in more ways than one"

As you've been reading, as a 401(k) plan sponsor, you can't be an absentee landlord. You need to be diligent and you need to remember that the plan is for the benefit of your employees. If you give your employee a good, cost-effective 401(k) plan, it will pay you back in employee retention, as well as retirement savings for yourself. Giving will get it back to you in return. That works the same in employer contributions. Providing for employer contributions can help you retain and recruit talent, it can also lead to greater retirement savings for you. Safe harbor contributions and/or minimum gateway contributions to your non-highly compensated employees could lead to bigger contributions to you as business owners and your other highly compensated employees. So paying it forward to your employees in creating the plan and providing for employer contributions, will return it to you in different kinds of dividends.

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