Curb Your Enthusiasm On These Annoying 401(k) Practices

By Ary Rosenbaum, Esq.

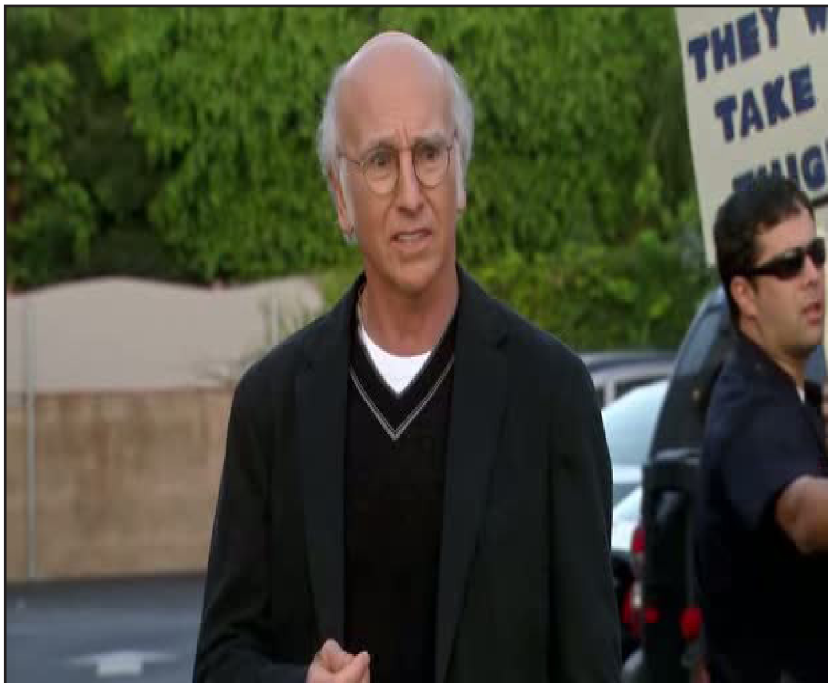
One of my favorite TV shows of all time is Curb Your Enthusiasm. It may be sacrilege, but I enjoy the show as much as Seinfeld. One of the reasons I love the shows is because I love Larry David as played by Larry David (he is playing a fictionalized version of himself). I see some part of me in Larry, but Larry takes it to the extreme. Unlike me, Larry refuses to pick and choose which battles to fight and he often stubbornly focuses on petty details and his opinion to the extent of aggravating everyone around him just to prove an insignificant point. For this article, I'm going to express what aggravates me about the retirement plan business that you probably don't even know as 401(k) plan sponsors.

Definition of Highly Compensated Employee

The definition of a Highly Compensated Employee (HCE) is important because most discrimination testing for your plan is predicated on making sure that your plan doesn't discriminate in favor of HCEs. The definition of HCE Owned more than 5% of the interest in a business at any time during the year or the preceding year, regardless of how much compensation that person earned or received compensation from the business of more than $130,00 if the preceding year is 2020 or 2021, and, if the employer so chooses, was in the top 20% of employees when ranked by compensation. The problem I have with the HCE definition is the $130,000 (it increases with inflation). I live on Long Island and when I was making more than that as an associate attorney 10 years ago, I assure you that I wasn't highly compensated. $130,000 may go farther in many other states (especially those without a state income tax), but even then, I think the limits should be increased by at least another $20,000 to be more accurate.

The Actual Deferral Percentage (ADP) Test

The ADP test compares the average salary deferrals of HCEs to that of non-highly compensated employees (NHCEs). Each employee's deferral percentage is the percentage of compensation that has been deferred to the 401(k) plan. To pass the ADP test, HCE deferral rates need to fall below these thresholds: If the ADP rate for NHCEs is 0%-2%, the ADP for HCEs must not be more than 2 times the NHCE rate. If the ADP rate for NHCEs is 2%-8%, the ADP rate for HCEs must not exceed the NHCE rate by more than 2%. If the ADP rate for NHCEs is greater than 8%, the ADP rate for HCEs must not be more than 1.25 times the NHCE rate. The problem with the ADP test is that it misses the point of salary deferrals, lower-paid employees have less money to defer than those who make more money and it's predicated on the HCE limit being artificially low (as discussed above). ADP test is a discrimination test and I don't know if the rate of HCEs deferring more than NHCEs is really discrimination. I'm not saying we shouldn't have an ADP test, but we need limits that make more sense when dealing with the reality of the ability of employees being able to save for retirement. These rules were written when plans were a bonus and many employees could rely on a pension plan as a safety net for retirement. For most employees, these days, a 401(k) plan (for those employees where their employer) is all they got and I just think that the current ADP test rule, severely limits that. I'm all for an ADP discrimination test, but I think the differential between HCE and NHCE should be more than 2%.



The length and non-uniformity of Fee Disclosure Forms

In 2012, a revolutionary thing happened in the retirement plan business. For the first time, 401(k) plan sponsors like you were allowed to finally get a disclosure of all fees charged to your plan by retirement plan providers. It was a necessary development because 401(k) plan sponsors like you have a fiduciary duty to pay only reasonable plan expenses. Before the fee disclosure regulations, 401(k) plan sponsors would only know what fees they were being charged if their providers were fully transparent and many providers at that time liked to hide the ball. If there is one fault I have with the Department of Labor (DOL) is that they dropped the ball by not requiring a uniform

form for fee disclosures. Model forms in disclosure of nutritional information on food products and model Federal Truth in Lending forms for mortgages create uniformity help break down difficult concepts in a language that people can understand. Well, we didn't get that with fee disclosure forms. Many providers think that the more pages they can put in their forms is for the better. Other providers use confusing language that they need an ERISA attorney like me to try to decipher. One of the hallmarks of my practice is that outside of governmental audits, my work is based on a flat fee. So clients know exactly how much they are paying, nor more and no less than what is clearly described in the retainer letter. For fee disclosure forms, we don't have a simple and fully transparent breakdown of fees among all providers. Some providers are very clear and concise, but many still aren't. I still think we have some work to do on fee disclosures.

TPA Termination Fees

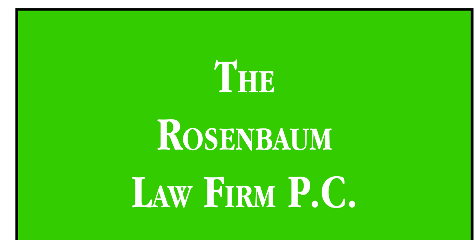
I am a huge New York Mets fan and one of the best managers that my team ever had not named Gil Hodges was Davey Johnson. Davey managed the team to the 1986 World Series title and a National League Eastern Division title in 1988 (still peeved he started Ron Darling instead of Dwight Gooden in Game 7 against the Dodgers). When Davey was under fire, a caller to radio station WFAN asked Davey "if he was hired to be fired."30 years later, I remember that line because it's so true. Eventually, all things come to an end and that includes relationships with plan providers such as your third-party administrator (TPA). Yet unlike most professional relationships that conclude, most TPAs charge a termination fee. In the old days, the termination fee was rather silent and I worked for people in the industry who charged whatever termination fee they wanted. Thanks to fee disclosure, the termination fee is now transparent, but I'm still against it. I have several clients that pay me a monthly retainer, I don't charge extra if my client decides to let me go. I'm sure TPAs will explain that they have work to do to de-convert a plan and allow the switch to the succeeding TPA, but I think termination fees are something that either TPAs should swallow or base that into their annual fee. When signing that TPA contract, always keep in mind the termination notice requirements and the termination fees for firing them because they are "hired to be fired."

TPAs charging an asset-based fee

I have a good friend who is a salesman for a TPA. Many years ago, he gave me a proposal where his company would charge an asset-based fee, in addition to a $2,500 minimum. I asked him point-blank if there was a cost difference for his TPA to administer a 100 person $10 million 401(k) plan and a 100 person $100 million 401(k) plan, he had no answer because outside of custodial fees (charged by the plan's actual custodian), the answer is no. TPA work is a per head business, more participant accounts they have to create and watch, the more work there is. Whether participants have a $10,000 average or $100,000 average, the work or the TPA is the same. TPA fees should be based on a minimum and a participant head charge (many now charge a flat fee), taking a piece of the action (the 401(k) plan's asset) through an asset-based fee makes no sense to me.

Payroll Provider TPAs

My opinions are shaped by my experiences and my opinions change over time. For example, my opinion regarding "producing" TPAs (TPAs with its own affiliated investment advisory firm that works on the plans they administer) have mellowed thanks to fee disclosure regulations. My well known and long-standing opinions concerning payroll provider TPAs has not mellowed. The two largest payroll providers in the country are two of the biggest players in the 401(k) TPA market. The problem is that they haven't shown that they are up to the task of administering plans consistently and competently. While I have certainly burned my bridges with the payroll provider TPAs because of my well-known criticism, but a good chunk of my practice is fixing 401(k) plans after they terminated these payroll providers TPAs. The problem with payroll provider TPAs is that they are payroll providers who treat the TPA business as a true ancillary business in terms of competence. They haven't shown a commitment to great service and they refuse to offer the "hand-holding" to 401(k) plan sponsors that I find with other TPAs in terms of services and plan design. Payroll provider TPAs lack communication skills in terms of the annual compliance testing, Form 5500 preparation, and whether a plan design should be changed. I've had enough clients with payroll TPAs where the compliance testing was not done or done incorrectly and the payroll provider TPA will immediately check their contract with my client to disclaim any liability. Don't hire a payroll provider TPA for cost savings or "synergy" with payroll, hire a TPA who commits to quality work.



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