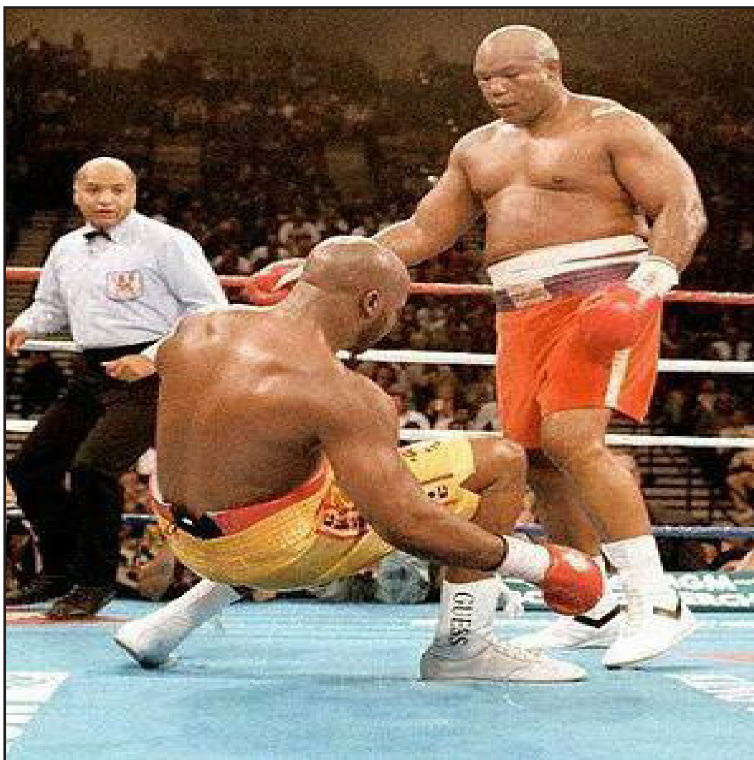
It Happened! Weird Things That Have Happened To 401(k) Plans

By Ary Rosenbaum, Esq.

I'm a big boxing fan and one of my favorite fights of all time is when George Foreman regained the heavyweight title at age 45 by knocking out Michael Moorer in the 10th round. Jim Lampley who was announcing for HBO and worked with Foreman on so many broadcasts, was in shock when he proclaimed: "it happened, it happened." Having been an ERISA for 22 years, I have thought I'd seen it all until I see something again that I'm shocked by. Here are some examples of some strange things that can happen and have happened to other 401(k) plan sponsors as a warning to you.



Not signing plan documents and amendments

Retirement plans like 401(k) plans must have written plan documents. Also, there are certain times that the Internal Revenue Service (IRS) requires you to restate your plan into a new plan document or amend your plan because of a change in the law. If you fail to restate or amend your plan within the time limits set forth by the IRS, that is grounds for your plan to be disqualified where you would lose your business tax deductions for employer contributions and participants recognize their retirement savings as immediate taxable income. If the restated documents and/or amendments are missing and even if you're sure you did them, the IRS takes the position that the documents don't exist. The problem with plan sponsors that even if they have had these documents drafted by their ERISA attorney or a third-party administrator (TPA) they must be properly signed and dated by the deadline prescribed by the IRS. I just had a plan sponsor spend over $3,500 in legal and IRS fees to submit a plan to the IRS' Voluntary Compliance Program just because they discovered a 2011 plan restatement that wasn't properly signed and dated. Not signing a plan document or amendment that has been drafted by the prescribed deadline seems to be a dumb mistake, but it happens. What is worse than making a mistake is discovering the mistake during an IRS or Department of Labor (DOL) audit, which could subject you to penalties.

Not verifying hardship distribution requests

I am a pro wrestling fan (don't judge me) and my favorite wrestler was Stone Cold Steve Austin. I just purchased a retro shirt that I owned a version of more than 20 years ago that says on the back: "Don't Trust Anyone." While I trust my wife and the plan providers I work with, I don't trust plan participants. I say this as an ERISA attorney, a plan sponsor, and a plan fiduciary. When it comes to hardship distributions, you can't take a participant's word that they have a hardship. They need to show you documentation of that hardship, as well as the dollar amount of that need. Hardship distributions are supposed to be for actual hardships, so you need to verify the actual need. Over the past few years, IRS agents have been asked by their management to verify hardship requests on audit, as well as concentrating on participants who have asked for multiple hardship requests. It's surprising how many plan sponsors don't verify hardships, so even just give blanket approval for their TPA to approve. While participants should be entitled to their account balance if they incur a hardship and the plan offers a provision, you still need to verify.

Fraud by former employees and others with distributions

Theft of participant account balances is rare, but you need to be vigilant to ensure that only participants can receive a distribution from the plan, instead of people claiming to be the participant. It's important to ask all your providers as to any cybersecurity policy or protocols to thwart identity theft that they have and keep check of all distribution requests. Understand the process as it relates to distributions and decide whether. As someone in this retirement plan business for 22 years, I haven't seen cyber theft or identity theft in distributions, but it has happened. There was a recent lawsuit against a well-known cosmetics company regarding cyber theft of a participant's account balance. What I have seen as an ERISA attorney is former

employees who claim that their distribution was stolen and cashed in by someone else. The only issue was that in both situations, the former employee was lying. In one situation, a former employee claimed that their distribution check was stolen and cashed in by somebody else. The only problem is that the TPA was able to track down the check-cashing place where the distribution check was cashed. The only problem was that the former employee was caught on video surveillance and using his drivers license to cash in his own check. When confronted with these facts, the former employee insisted it was his twin brother who cashed the check. I wasn't interested in whether the employee had a twin brother or to call the police on an attempted fraud claim, I just wanted him to acknowledge he received a full distribution from his account and he did.

Not checking trust statements

I have met as many retirement plan providers who stole from their clients' 401(k) accounts as I have former employees who were trying to defraud their former employer by claiming someone else stole their distribution check. I will never understand why someone serving as a retirement plan provider in a fiduciary role would steal from their client's 401(k) plan. First, the provider is betraying the trust invested in them by their plan sponsor client. Second, stealing as a plan fiduciary has fingerprints all over as a trust statement will indicate when distributions are made from the trust account. The problem is that it takes time for the theft to be detected and one of the reasons why is that the plan sponsor either doesn't have access to a trust statement or never bothered to look at it. As a 401(k) plan sponsor, you have a duty of care as a plan fiduciary. Not reviewing a quarterly trust statement is a breach of your duty and could give someone the wrong idea on what too with your plan assets. Simple vigilance will deter theft.

Not reviewing what the plan providers are doing

Too many plan sponsors are like a villain in a James Bond movie who assumes their death plan for James has happened after leaving him to die. You're a plan fiduciary and one of the things you have to do is check on your plan providers and make sure they're doing their job. You can't afford as a plan fiduciary to assume that your plan providers are doing their job and competently doing their job. I once represented a plan sponsor who was being sued by the DOL for million in the mistaken belief that the plan sponsor embezzled money from their retirement plan account. The reason the DOL had that mistake assumption is that the TPA didn't bother to prepare valuation reports for the plan for 25 years and gave the plan sponsor bad advice that it was okay for the owner to transfer their benefit directly from the plan to another company of theirs. Too often, a plan sponsor lands in trouble because of the malfeasance of a plan provider, and the errors are found too late. By overseeing your plan providers, make sure they're doing their job, you're going a long way in avoiding a catastrophic plan error.

Overpaying plan providers

You have a fiduciary duty to pay only reasonable plan expenses for the services provided. No matter how much you may love your providers, you can't overpay your plan providers. Overpaying your plan providers would be a breach of your fiduciary duty, yet I knew one financial advisor who wanted a plan sponsor to do that once. A side business of mine is serving as an ERISA §3(16) administrator. On one plan, the TPA had a habit of overpaying the plan providers by accident. I was overpaid, I held the money in escrow, and returned it when the TPA confirmed they did that. The financial advisor for the plan was amid changing companies. It seems that his old company was paid the annual fee for a plan year quarter, which was four times the contracted fee. The advisor suggested I make the plan whole for the error. I told him the TPA made the error and the easiest thing to correct it was to return the excess fee. Instead of taking my advice, the advisor convinced the plan sponsor to ask me to make the plan whole. I advised the plan sponsor that making the financial advisor four times the fee was a prohibited transaction because even if I fixed the error out of my pocket, the advisor's former employer was not entitled to the fee. When I advised them that this was a prohibited transaction in the eyes of the IRS and DOL, the advisor and his former employer finally folded their cards and agreed to return the fee. As a plan sponsor, not only must you make sure that the fees you pay are reasonable, you also need to make sure you are not paying more than you should and more than you agreed to.

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