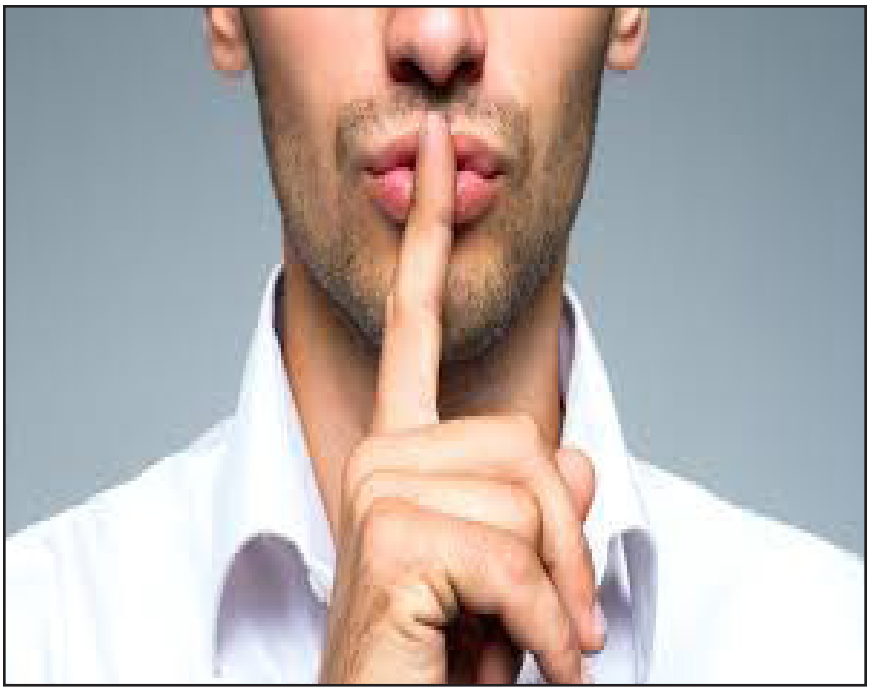
Things That Plan Providers Don't Tell You as a 401(k) Plan Sponsor

By Ary Rosenbaum, Esq.

When my wife and I bought our house, there were quite a few things that the previous owner forgot to tell us such as the fact they never bothered to pull the pipes from the dental office run by a previous owner 20 years earlier or all the bad carpentry work that the husband was a complete failure at doing it himself. When it comes to an employer sponsoring a 401(k) plan, there is no set of instructions given to you on how to properly operate one. So this article is about the things they forget to tell a plan sponsor in operating a 401(k) plan.



You're Always On The Hook For Liability

No matter whom you hire as a retirement plan provider, you will always be on the hook for liability as a plan sponsor. As a plan sponsor, you are a plan fiduciary, which is the highest duty of care in equity and law because you are holding the retirement plan assets for your employees and you're responsible for that. So even if you hire someone who advertises themselves as an ERISA fiduciary who claims they will take away all of their liability, you still have potential liability if you hired an ineffective plan provider.

If your plan provider is incompetent, it's your fault

If you hire a bad contractor for your home (been there, done that a few times), it's not your fault. If you hire a bad retirement plan provider, it is. Again, you have a higher duty of care because you are a plan fiduciary so you are responsible for the errors and incompetence of your plan providers. So that's why it's paramount that you review your plan providers for their work and if there are any errors that they create along the way that might be a reason for considering a plan provider change. Retirement plan administration, especially for 401(k) plans are highly technical and there are so many things that could go possibly wrong in the day to day administration. It's my claim that every plan has something wrong and it's just a matter of the degree. There can be substantive penalties for certain plan errors especially if these errors are caught on an audit by an Internal Revenue Service (IRS) agent. You need to keep an eye on your retirement plan providers before it's too late.

Even if the plan participants select their own investments, you still may be at fault

The idea of a participant-directed 401(k) plan is that plan sponsors have their liability limited if a participant suffers a loss in their account if the participant directs their own investments. It's a nice idea if actually exercised properly. ERISA §404(c) is supposed to limit the liability of a plan fiduciary for losses incurred by a plan participant if they direct investments if the plan fiduciary gives plan participants enough information to make investment decisions. That means a plan sponsor has to make sure that plan participants are given some form of investment education and education doesn't mean just handing them mutual fund prospectuses. A plan may also consider offering participants investment advice that is specific advice geared towards a participant's specific retirement needs, As a plan sponsor, you also need to make sure that the plan investment options are still sound options and the way to do that is to have an investment policy statement (IPS) which serves as the blueprint as to what type of investment options should be offered and what should be replaced. Of course, you will need a financial advisor to help you draft the IPS and make investment plan reviews on a continuous basis to determine whether the investment options need to be replaced or not. Too many plan sponsors have learned it the hard way that they are still on the hook for liability for the investment losses incurred by their participants. It should also be noted that a plan participant's rate of return is irrelevant, it's all about how you managed the process and if you handle the process correctly, you will not be liable even if a plan participant loses their shirt (and their account balance).

Fee disclosures make your life harder

Fee disclosure regulations implemented by the Department of Labor (DOL) made

plan sponsors' lives harder, not easier. Since all plan providers who get $1,000 or more through plan assets have to disclose all fees to plan sponsors, you no longer have any excuses as to why you don't know what the plan fees are. Now that you have fee disclosures from your plan providers, you actually have to make something of it and I don't mean a hat or a brooch or a pterodactyl (obligatory Airplane! movie reference). When you get the fee disclosures you can't just put it in the back of your drawer. You're going to have to determine whether the fees you are paying are reasonable for the services you are receiving. That means you'll actually have to benchmark those fees to see if they are reasonable or not. In addition, if you don't get the fee disclosures that you're supposed to, it's all your fault if you do nothing because you run the risk that your dealings with the plan providers could be considered a prohibited transaction with possible penalties. In addition, you're also on the hook if you don't provide fee disclosure to your plan participants. The good old days of not caring what fees being charged to the plan (that your participants were paying for) are long gone. When it comes to plan expenses, you will now have to be more vigilant.

You have to consider the costs of your investment options

One thing that your plan providers don't have to tell you, but you have to tell your plan participants is the cost of the investment options under your plan. Based especially on how mutual funds cost to plan participants, it's actually more important these days thanks to some recent litigation. Mutual fund companies make money by charge expense ratios on the funds they offer and the fact is that funds with high expense ratios eat into any gains a participant may earn with certain mutual funds. Some of these mutual funds pay revenue sharing to a TPA which helps subsidize the cost of plan administration and some mutual funds companies offer what I call an alphabet soup of multiple share classes of the very same fund with varying expenses and some back load charges. The problem is that a plan sponsor must understand which share class of the mutual fund they have and what those expenses are as well as if there are less inexpensive shares classes of the very same fund available. In the groundbreaking case in California called Tibble v. Edison, a plan sponsor was held to violate their duty of prudence when offering a more expensive share class under the plan when a less expensive institutional share class of the very same fund was available. So you could be liable for not shopping around and finding the cheapest share classes of the mutual funds you are currently offering. Also, there has been much litigation on revenue sharing because revenue sharing paying mutual funds are always going to be more expensive than mutual funds that don't. There has been a growing amount of cases that have held plan sponsors are liable for a breach of fiduciary duty if the selection of the mutual funds for the plan were based on the revenue sharing they paid. So you must be aware of the expense ratios of the investments you offer and determine whether they are reasonable or not.

That fiduciary warranty is worthless

A warranty sounds like something nice when a manufacturer puts out a warranty on their product because it means they stand behind their product. How much do you think the warranty is worth if the product never breaks or only covers defects in minor circumstances so that the warranty will never be used? Insurance companies that are plan custodians offer fiduciary warranties. We all know that insurance companies make money by insuring risk. So how much is that warranty worth as insurance if they give it away for free? You get the drift. When you hear the words "fiduciary warranty", I assume you think that these plan providers will either serve in some sort of a fiduciary capacity or indemnify you in any lawsuits brought by plan participants for any claim for a breach of fiduciary duty. Of course, these providers go out of their way to make sure that they are not identified as serving in any fiduciary capacity and the fine print in these warranties indicate that the providers will only defend you in only in rare instances. The warranty only states that the investment options that this provider selected were prudent, satisfied the Section 404(c) requirement of offering a "broad range of investment alternatives", and that the investment strategies provide a suitable basis for plan participants to construct well-diversified portfolios. That whole broad range requirement is rather broad; I am unaware of any plan fiduciaries ever being sued on that requirement. To comply with the simple broad range requirement, the plan fiduciaries must first decide on the asset classes (e.g., stocks and bonds) and styles (e.g., large-cap U.S. equity growth fund, small-cap U.S. equity value) for the "core" investments of the plan. So you need to offer a diverse group of investments, which almost every plan does. A fiduciary warranty is no protection for you, it's like buying car insurance that only covers you in a head-on collision or a life insurance policy that only pays for accidental death. It's a warranty that warranties very little and that's why providers who offer it will give it to you for free

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