401(k) Plan Sponsors Should Avoid These Solutions That Look For Problems

By Ary Rosenbaum, Esq.

For 24 years, I have helped retirement plan sponsors solve huge problems of their own. From a plan investing with Bernie Madoff to a plan that was late in depositing salary deferrals, I have seen almost every problem imaginable. Sometimes, 401(k) plan sponsors look for solutions for their retirement plan that create problems. This article is a caution that some "solutions" are no solution at all, but may cause problems you don't need.

Offering "unlimited" funds on a fund lineup

When I grew up as a kid in Brooklyn, going to a Ponderosa Steakhouse was a treat because this wasn't something that we had in Brooklyn. What was great about Ponderosa was the buffet, even if I was a picky eater as a kid. Places with buffets are popular because it offers choice and variety. I am a first-generation born American and one of the beauties of this country is choice and an abundance of choice, much different than what my grandparents had in communist Romania or austere newly created Israel. We think more is more, but that isn't the case when it comes to retirement plan lineups. I have seen 401(k) plans with 50-90 investment choices and while you might think that having 5 large cap mutual funds on a fund lineup, you would be wrong. Studies have shown that too many funds on a 401(k) plan lineup negatively affect active participation by plan participants. Why? Too many plan participants get overwhelmed by choice into an investing paralysis where the information overload scares them into active deferral participation. A fund lineup of 12-24 investment options is "more" than a fund lineup of 50-plus investment options.

Too many proprietary funds on a fund lineup

Bundled and unbundled recordkeeping and third-party administration (TPA) solutions from a mutual fund company look sense on paper. Mutual fund companies such as T. Rowe Price, Vanguard, Fidelity, and others, offer an attractive 401(k) offering for plan sponsors. I'm a fan of these mutual fund companies. However, we should realize why not only they're in the recordkeeping/TPA business. These mutual fund companies see that offering these solutions to 401(k) plan sponsors is a great way to distribute their mutual funds, which also increased what they collect in management fees. If you're a 401(k) plan sponsor and want Fidelity to be the TPA on your plan, you're not doing it because you hate their mutual funds. By hiring a mutual fund company as your recordkeeper and/or TPA, you're going to offer their proprietary funds on your mutual fund lineup. They need to make money and you like their funds. The caveat if fully loading your mutual fund lineup with only funds from one particular company is an issue as a plan fiduciary. Being a plan fiduciary requires the highest duty of care in equity and law, it's got to be rational and above board. No mutual company is great at every different asset class, it would make no sense to have all funds from one company, which happens to be the plan's recordkeeper or TPA. Fiduciary decisions have to look like they are above board and having all your funds from your plan provider doesn't look good. If things don't look good, aggrieved plan participants, an agent from the Department of Labor (DOL), or an ERISA attorney may assume things are being done incorrectly.

Offering unlimited plan loans

Again, I find that when it comes to retirement loan administration, less is more. While I think 401(k) plans should offer loans to participants, it should be done with a one-loan outstanding limit. A 401(k) plan shouldn't be a bank or a payday loan service. Since loans are usually repaid by payroll, offering unlimited loans increases

the chance that one or more loans won't be paid off timely, resulting in a default and a taxable deemed distribution to participants. Tracking loans is like juggling, too many will make you drop one or two. I have no issue with allowing participants to refinance or revisit the terms of the loan, I just think a participant having 7-8 loans is just going to increase the likelihood of a plan record-keeping error, which would incur a default and taxable distribution to a plan participant.

Offering crypto investments in a 401(k) Plan

I have to preface that I invest in Cryptocurrency and I'm in the red as Bitcoin has gone from about $69,000 to $19,000 now. What I do with my money is my business, what you do with a 401(k) plan is your business, the business of participants, and the business of the DOL. They say that timing is everything in life and a plan provider trying to offer Bitcoin as a participant-directed investment within a 401(k) plan is bad timing. It's bad timing because of the crypto crash and it's bad timing because the DOL has negatively opined on it. The DOL has serious concerns about crypto investing. Crypto investments are volatile, unregulated, and prone to cyber theft. Even as a crypto investor, I had serious misgivings about offering such an option before the DOL issued its opinion on the matter. The DOL effectively said that any plan sponsor offering a crypto investing window in their plan may be investigated. With all due respect to most plan participants, they lack the sophistication and temperament to invest in a volatile asset such as cryptocurrency. Until the DOL gives the green light for you to offer a crypto investing window in your plan, you should stop on red.

Offering ESG funds

I'm all for the environment. I drive a Prius V, I recycle, and I love vegan food options. However, I'm not a fan of allowing ESG options within a 401(k) plan. If you don't know, ESG funds are portfolios of equities and/or bonds for which environmental, social and governance factors have been integrated into the investment process. ESG investing to me is more about making a political statement than what's more important for the fiduciary process, finding the investments that can give participants a better rate of return. In addition, ESG funds remind me of sector funds and I'm not a fan of those being offered in plans either. Thirdly, what one fund company deems appropriate for an ESG investment, may be different from another fund company because of a different interpretation of what a proper ESG investment is. Lastly, while the Biden administration relaxed the rules on ESG investing, this rule will always be subject to who is occupying the White House. It's the end of 2022, I can't guarantee who will occupy the White House on January 20, 2025. Who will occupy the White House will determine whether ESG funds are going to be OK or not. I'm a long-term vision guy and I wouldn't want investment options that are good or not, depending on who is occupying the Oval Office.

Hiring your payroll provider as your TPA

If you know nothing about 401(k) plans, you would think Paychex and ADP would be great as your TPA because they also handle payroll. Why not? Keep everything under one roof. The problem? Paychex and ADP aren't very good when it comes to plan administration. Their bread and butter is payroll and they certainly act as if their TPA services are just ancillary. Unlike most TPAs, these payroll providers expect you to have knowledge about 401(k) plans that you don't have. That means little assistance in helping you run your plan, as well as them making more errors than the typical TPA. The truth is that outside of deferrals and loan repayments, 401(k) plans have little to do with payroll. These payroll providers tout 360 integration with payroll, but other payroll companies offer 360 integration with TPAs, and ADP and Paychex offer 360 integration with other TPAs as well. My frank assessment of payroll provider TPAs don't get me many clients, but I end up with more clients with errors caused by their fired payroll provider TPAs.

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The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw