THE ROSENBAUM LAW FIRM P.C.

Perspectives

A Monthly Publication
For Retirement Plan Sponsors
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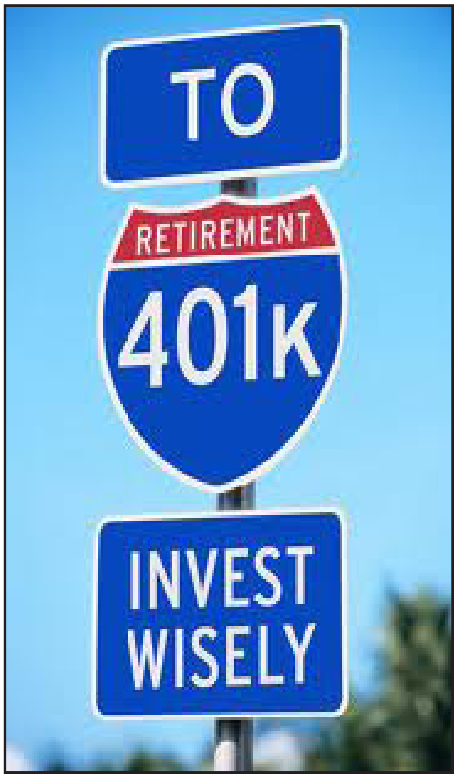
Volume 1 Issue 2
September 2010

The Myth of Free Administration

There is no such thing as free lunch or free 401(k) Administration

As noted in a previous article that I wrote concerning the Top 10 Major Misconceptions that a Plan Sponsor has about Retirement Plans, the biggest misconception is that many Plan sponsors believe that they get free administration of their 401(k) Plan. While fee disclosure regulations that the Department of Labor will implement in July 2011 will give Plan sponsors a dose of reality, that will still give them almost a year before they get sticker shock.



The myth of free administration tends to be a creature of insurance companies. Insurance companies offer a low cost 401(k) program that is attractive to small companies or new 401(k) plans that have very few assets. While most independent third party administration firms (TPAs) may have minimum annual recordkeeping fees that may be between $2,500 and $7,500, an insurance company can offer their services for $1,500 or less, or even "free."

How can an insurance company offer recordkeeping services for free? Well, the recordkeeping services aren't free, they're "free." The mutual funds that an insurance company offers include the mutual fund (with their underlying management fee) and a wrap fee. While the local department store offers free wrapping, the insurance companies' wrap fee isn't free. The wrap fee is an additional asset based fee that a Plan sponsor rarely sees or never sees if they swear they get their administration for free.

There is nothing wrong with a wrap fee because an insurance company needs to make money and the fact is without this wrap fee, most small 401(k) plans would probably never be implemented because of the high administrative cost for Plans that don't use the annuity arrangement offered by insurance companies. While there is nothing wrong with a wrap fee, the point is that Plan sponsors should understand that it does exist and that there is a cost involved with the administration of their Plan.

While 401(k) plans with little assets may be wise to stick to this arrangement, Plans that have increased to a size of critical mass ($1 million to $2 million) should consider whether this wrap fee arrangement is still attractive or whether going with an unbundled TPA is less expensive. While the unbundled TPA may have a higher recordkeeping fee (the $2,500 to $7,500 fee discussed earlier), they may now be less expensive than the wrap fee since the Plan has more assets (which increase the amount of the fees generated by the asset based wrap fee). In order to properly exercise their role as plan fiduciaries and to limit their liability, Plan sponsors should annually review their administration fees including a wrap fee to determine whether the fees they pay are reasonable for the services they see.

I have seen too many 401(k) plans with millions in assets that pay too much in administration fees because they are under the mistaken belief that they pay nothing for administration. While their advisor may have a nefarious reason as to not letting the Plan sponsor know about the high wrap fees, I have run into many 401(k) advisors who don't even know that a wrap fee exists. There is still too much ignorance in the 401(k) marketplace and ignorance costs money.

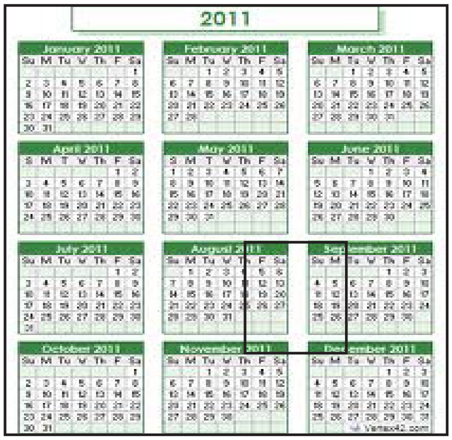
I would also advise plan sponsors that are about to implement a 401(k) plan with an insurance company to retain a retirement plan/ ERISA attorney to review contract terms with the provider to determine the wrap fee as well as the length of the contract and any surrender charges for early termination. This will ensure that there is no sticker shock when the fee disclosure regulations are finally implemented and to advise a Plan sponsor when changing to an unbundled TPA may make economic sense.

Again, an insurance company provided 401(k) plan may make sense when a Plan is smaller and even when a Plan is larger, depending on their program. Insurance companies offer Plans with different pricing structures, but a Plan sponsors are breaching their fiduciary duty by not knowing their cost structure. There is no such thing as a free lunch or free 401(k) administration.

Getting Ready for the 2011 Plan Year.

Now is the time to consider changes to your retirement plan.

With September 1 just passing us by and the start of the third quarter around the corner, now is the time to consider changes for the 2011 Plan Year.



If you are interested in changing your third party administrator (TPA), now is the time to act to make sure of a timely December 31st transition and a January 1st start date with the new provider.

Also if you are interested in adding bells and whistles to your Plan that may include automatic enrollment, in-service distribution option, or a 401(k) safe harbor design for 2011, please contact us.

A safe harbor design for a 2011 calendar year Plan will require a safe harbor notice to be distributed to participants by December 1, 2010.

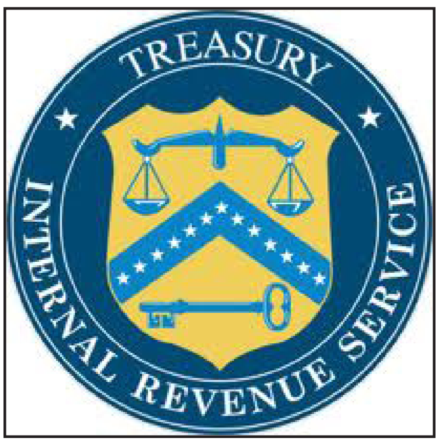
If you are interested in starting a defined benefit plan for the 2010 calendar year, the Plan must be signed on or before December 31, 2010.

For all your retirement plan, consider The Rosenbaum Law Firm P.C., where we draft retirement plan documentation for a flat fee. Your retirement may be uncertain, your retirement plan legal fees should not.

The Truth About Plan Disqualification.

It's a threat by the IRS that is rarely used.

A financial advisor that I have known for many years recently lamented to me that a client has already spent $100,000 in legal fees to an ERISA attorney for what was supposed to be, just a restructuring of their retirement plans.



The attorney was reviewing the administration of the Plan and discovered that instead of reallocating forfeitures as the Plan document stated, the Plan was using forfeitures to reduce their employer contribution. The attorney stated that this was a prohibited transaction and the Plan could be disqualified. Just like Admiral Kirk told Dr. McCoy "Calm yourself, Doctor" after McCoy wondered whether the Enterprise would walk through space doors in Star Trek III, I think that ERISA attorneys need to calm themselves when talking to their clients about plan disqualification.

All qualified retirement plans need to abide by the Internal Revenue Code and the regulations promulgated by the Internal Revenue Service (IRS). A retirement plan that fails to comply with the Internal Revenue Code can be disqualified. However, plan disqualification is the death penalty for retirement plans and is only used in rare instances.

Plan disqualification is considered the death penalty for retirement plans because with disqualification, the Plan's trust loses its tax exempt status. By the Plan losing tax exempt status, prior employer tax deductions for contributions are reversed and plan participants are subject to immediate income taxation of their vested contributions made on their behalf and can't roll over these amounts into an IRA or another qualified plan.

Since the IRS has enough of a bad reputation, they don't want to be in the business of destroying the retirement savings of innocent plan participants. They let the stock market do that.

Seriously, the IRS uses plan disqualification as a penalty of last resort. Like the death penalty, it's only used for egregious cases and the IRS has implemented programs to encourage Plan sponsors to self-correct plan defects. Even when finding defects on an audit, an IRS agent will likely impose fines . The plan disqualification penalty is likely implemented when the IRS determines that the defects were so egregious, that they cannot be corrected to comply with the Internal Revenue Code. Typically, single employee retirement plans with exotic insurance funding can be a target for disqualification if the insurance funding circumvents IRS rules.

While Plan disqualification is rarely used, Plan sponsors still need to understand that failure to comply with the Internal Revenue Code puts the Plan at risk for penalties and the Plan sponsor for breach of fiduciary duty. Scaring Plan sponsors of plan disqualification should only be used when the Plan defect warrants it, not for a simple defect that can easily be self corrected.

Always use the services of an ERISA attorney for plan defect issues, just make sure they don't yell plan disqualification to justify their exorbitant fees.

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