Focusing Just On Fees Can Make 401(k) Plan Sponsors Neglect Other Problems

By Ary Rosenbaum, Esq.

Thanks to regulations requiring fee disclosure, media coverage, and a lot of litigation, 401(k) fees are still a huge topic for plan sponsors. Retirement plan providers talk about fees all the time because it's a huge fiduciary concern and it's a great marketing hook to get new 401(k) plan sponsor clients who are probably paying too much in fees. While focusing on fees is a great thing that 401(k) plan sponsors can do, focusing only on fees is an absolute mistake. The reason is that focusing only on fees may cause a plan sponsor to neglect the other issues that may affect the 401(k) plan and cause the plan sponsor pecuniary harm. So this article is all about the other issues that may be a threat to a 401(k) plan besides just fees.

Fees just have to be reasonable

While all the talk about fees is that some fees are just too damn' high, the fact is that a plan sponsor's fiduciary responsibility is to pay reasonable plan expenses. People forget the whole reasonable part and only focus on low fees. 401(k) plan sponsors don't have to pay the lowest fees, they just have to make sure that the fees are reasonable for the services provided. Picking the plan provider just because they charge the lowest fees is usually a mistake.

Not remitting salary deferrals in a timely fashion

One of the most frequent mistakes in dealing with 401(k) plans is something that's really avoidable and it's not transmitting salary deferrals that a participant made to the plan in a timely fashion. Department of Labor (DOL) rules require that the plan sponsor deposit salary deferrals to the plan as soon as the plan sponsor can; however, in no event can the deposit be later than the 15th business day of the following month. In the old days, we thought that the rules about the 15th business day was the actual rule. However, the DOL took the position that 15th day of the following month wasn't a safe harbor for depositing deferrals; rather, that the rules set the maximum deadline. So the DOL started to press on the timely remittance of salary deferrals and require plan sponsors to deposit them as soon as possible, certainly by the next payroll. I started fining plan sponsors for delaying the deposit to the point where they created a voluntary compliance program for plan sponsors to fix errors. In addition, it's a question on Form 5500 on whether plan sponsors are late for depositing salary deferrals. If the answer is yes, it's a target for a plan audit and you will be notified by the DOL if you haven't participated in their compliance program to fix the error. When you think about it, it's a really silly error because the money belongs to plan participants and should be deposited as quickly as possible. There might be extenuating circumstances why a deposit can't be made timely, but that's rare. More plan sponsors get in trouble over late remittance over salary deferrals than they do over high fees.

Failing to file the Form 5500

Every plan covered under ERISA needs to file the annual Form 5500. Surprisingly, there are many plan sponsors who either forget to file the annual return or don't know that the TPA needed to draft one for their electronic signature. While the DOL has a delinquent filer voluntary compliance program where there are reduced, maximum compliance fees, most plan sponsors don't partake in the program. If the plan sponsor doesn't partake in the DOL program, they may get penalties from the Internal Revenue Service (IRS) and/or DOL. The IRS can charge $25 a day for a late filing to a maximum of $15,000. The DOL can now charge up to $1,100 a day with no maximum. A plan sponsor can get penalties for tens of thousands of dollars. It's a much costlier mistake than paying too much in plan fees.

Costly Compliance test errors

Qualified retirement plans like a 401(k) plan have compliance testing to make sure that the plan doesn't discriminate in favor of highly compensated employees. We're not talking about discrimination against groups of people; we're talking about contributions that benefit highly compensated

employees in a discriminatory fashion that the Internal Revenue Code sets down. Something as simple as highly compensated employees deferring more than 2% as a group more than non-highly compensated employees is considered discriminatory and needs to be fixed by corrective contributions or a refund of deferrals to highly compensated employees. Contributions can't be allocated in a discriminatory fashion, 60% of plan assets can't belong to key employees, and there are minimum coverage requirements as well. Plan sponsors also can't even have benefits, rights, and features that discriminate in favor of highly compensated employees. Even something like offering a feature like self-directed brokerage accounts have to be done employee wide and not just to the highly compensated employees. Compliance tests are done annually and if a plan sponsor fails, they need to take corrective action. These corrections need to be done when the tests are completed. However, there are many situations where a plan sponsor discovers that the tests were done incorrectly years after the fact. They're usually discovered when there is a change of TPAs and the new TPA discovers the error. The problem with discovering errors years later is the cost involved since many less costly corrective actions can be timed out, and there is the cost of having to submit the plan to the Internal Revenue Service Voluntary Compliance Program when required. The bigger problem is if these compliance errors are discovered on an IRS audit. IRS agents who discover compliance errors are certainly less forgiving than the TPA who finds it. If these errors are discovered on an audit, then the voluntary compliance program is closed, and the plan sponsor will be assessed penalties that aren't tax deductible. Compliance error headaches are a lot more common than 401(k) fee headaches.

The Affiliated Service Group/Controlled Group conundrum

As discussed, the Internal Revenue Service is concerned about retirement plan coverage and that non-highly compensated employees get retirement plan coverage. That's why they instituted rules where they treat multiple companies as one employer for purposes of retirement plan coverage. These rules were implemented to make sure someone starts another company with the major purpose of not having to cover employees from their other connected company. These rules are called affiliated service group rules and controlled groups to make sure that certain groups of companies are treated as one if there is the requisite affiliation or common ownership. Many times, the employer involved had no idea that there was some affiliation or common control because they didn't get the proper legal guidance. There is nothing worse than discovering that you failed to cover the employees you needed to keep the plan qualified. Again, this is another headache that is more frequent than concerns about fees.

Prohibited Transactions are prohibited for a reason

A retirement plan is for the exclusive benefit of its participants. To get that rule across, the IRS has prohibited transaction rules to block dealings between the plan and plan fiduciaries such as the plan sponsor or an owner of the company. That means that the plan sponsor can't take out a loan from the plan or sell something to the plan to benefit their bottom line. Many times, prohibited transactions can be a simple mistake such as letting a loan to a participant violate the exemption under the prohibited transaction because of missed payments (without defaulting it) or because the term of the loan exceeds the exemption limits. Prohibited transaction will incur excise taxes and if egregious enough, may result in a plan disqualification.

The hidden liability of participant direction of investments

Most 401(k) plans offer participants the right to direct their own investments. Plan sponsors who do that don't do it because they are magnanimous. They do it because it may limit their liability. The problem is that plan sponsors don't know that limited liability is only limited if the plan sponsor fulfills their duty to get that protection under ERISA §404(c). A plan sponsor needs to develop a process where there is a prudent selection of plan investments and they need to provide investment education to participants. Without a prudent process of investment selection and the providing of information to plan participants, plan sponsors may find out that they can be liable for the losses incurred by participants even though they sought that liability protection under §404(c). This is a common error for plan sponsors and it's because they haven't retained a financial advisor to help them or they have a financial advisor who doesn't know their role in the fiduciary process.

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