Clues That There are Problems With A 401(k) Plan Provider

By Ary Rosenbaum, Esq.

When it comes to illnesses and diseases, there are usually warning signs out there. Whether you can come out healthy from a debilitating illness or disease is dependent on whether you can tell the warning signs. I've seen people make miraculous recoveries and I've people die needlessly based on whether they caught the symptoms early or ignored them. When it comes to 401(k) plan providers, you need to know the warning signs as a 401(k) plan sponsor before some compliance issues becomes greater than it has to be. This article is about clues if there are issues with the plan providers you selected.

The plan sponsor doesn't understand that they are ultimately responsible

Most employers that sponsor a small to medium sized 401(k) plan don't understand their role. They think that the 401(k) plan is like any other employee provided benefit like reduced gym membership and the coffee machine. Unfortunately that's not the case because they also wear the hat of plan fiduciary when they are a 401(k) plan sponsor. That means they are responsible and entrusted with the retirement assets of their employees, so they have the highest duty of care. That means that even when they hire plan providers, they are ultimately responsible for what those plan providers do. Sure they can sue a 401(k) plan provider for any negligence, but the plan participants and the government are still going to hold the plan sponsor responsible because they are responsible for any negligent plan providers. Even if the plan provider assumes the bulk of fiduciary responsibility such as an ERISA §3(38) fiduciary that takes the responsibility and liability for the fiduciary process, there is still enough blame for the plan sponsor if something does go wrong. No matter what goes wrong, a 401(k) plan sponsor may still be on the hook and if they don't realize that, then that can be a telling sign that something could be wrong because they have no idea on their role as a plan sponsor.

The plan providers aren't promising what they contracted to do

One of the early tell tale signs that you have problem with your plan provider is when they don't deliver on their promises. What does that mean? It means they aren't delivering what they promised to do through their contract for services. If the plan provider is a financial advisor, one of the issues might be that they haven't delivered in the amount of promised meetings with the plan sponsor or failed to deliver on meeting the requirements of the investment policy statement or failed to provide the investment education to plan participants. If the plan provider is a third party administrator (TPA), what they're failing to deliver on maybe part of the compliance end of their work. I've seen too many plan sponsors who discovered that the top-heavy test or the Form 5500 promised wasn't done. So if the plan provider promises a plan sponsor a bill of goods and it's not being delivered, it's a big clue that something is wrong.

The plan providers aren't communicating

When you're hiring someone to do a job and they're not communicating with you, how do you know if they're doing their job? I learned that the hard way many times when I didn't see the home contractor I'd hire show up at my house. The same can be said for a 401(k) sponsor who doesn't hear from their providers on a regular basis. A plan sponsor doesn't need to hear from their 401(k) providers every day, but they need to hear from them every now and then to make sure that the plan's needs are being met. The best example is the financial advisor. For many years, I'd hear about the financial advisor who never bothered to see the client and advise on the investment options of the plan, but collected a fee every quarter. I called those advisors, "milk carton advisors" because they were missing so long that they needed to be placed on a milk carton like a missing person. Communication is one of the most important tools

for a plan sponsor to make sure that the plan they're responsible for as a fiduciary is in good hands with the providers that were retained.

The plan providers aren't pro-active

It's not enough that 401(k) plan sponsors need plan providers to be in communication with them. They also need to make sure that their plan providers are also pro-active if they sense any issue with the plan. Best example I have about a plan provider that wasn't pro-active was a client of mine who once had a payroll provider as their TPA. The 401(k) plan that the client had sponsored consistently failed the compliance tests for salary deferrals and matching contributions. One year, the owner of the company once had to refund $10,500 of her $12,000 in deferrals. The TPA never bothered to talk to her about utilizing a safe harbor 401(k) design that would eliminate the failed compliance test for deferrals. More importantly, they never explained the compliance reports at all. A note in the compliance report that the TPA could have explained would have allowed the 401(k) sponsor to correct the failed compliance test by just making a $7,500 qualified non-elective contribution to the non-highly compensated employees. So the owner of the company could have just made the $7,500 tax deductible contribution to avoid getting a $10,500 taxable refund she'd have to report on her personal taxes. Even financial advisors need to be pro-active. So many larger 401(k) plans are being sued if they are using retail share classes of mutual funds when less expensive institutional share classes of those very same funds are available. These larger 401(k) plans are being sued because the financial advisors aren't pro-active. Plan providers that are passive and don't let the plan sponsor know things they should know are a sign of trouble.

Providers are telling the sponsor to correct compliance issues that are their domain

If a 401(k) plan sponsor is late in depositing the salary deferrals into the 401(k) plan, it's understandable that the TPA tells them to correct the error since the employer made the mistake. Yet I've seen times where the TPA tells the plan sponsor to correct errors that the TPA caused and the TPA neglects to admit that. I recently came across a plan sponsor who was told by the TPA that they needed to submit the plan to the Internal Revenue Service for voluntary compliance because the plan document wasn't updated. The only problem was that the TPA had updated the previous plan document and never bothered to tell the plan sponsor that they needed a new one. Many times an ineffective TPA may tell the 401(k) plan sponsor to correct past compliance tests without bothering to admit they made the error. The unfortunate part is that many of these compliance errors go undetected for years and are usually discovered when the TPA is replaced and the new TPA detected the problem.

The provider is going through a lot of turnover

People like routines and they don't like change. So if a 401(k) plan sponsor is used to working with the same person or group of people working for a plan provider, it's a little upsetting when that person or group of people are replaced. Employee turnover is inevitable for any plan provider, but too much turnover could be signs of a problem. Changing multiple plan administrators to service a plan sponsor may cause questions about the TPA and the same thing as too much turnover over representatives from a financial advisor. Plan sponsors appreciate continuity and a frequent change of the plan provider's contact to the 401(k) sponsor isn't the continuity they want.

The plan sponsor doesn't review the plan provider's work

As discussed before, too many plan provider errors are only discovered when there is a change of plan providers. That's a problem if the plan sponsor doesn't change plan providers often. I've seen 401(k) plan sponsor used a particular plan provider for many years and then only discover compliance issues when there is a change of plan providers. This lack of discovery of plan errors is an issue because the 401(k) plan sponsor failed to have the work of their plan providers reviewed. In my practice, I offer a plan review called the Retirement Plan Tune-Up where I review the 401(k) plan and the other providers for $750 that can be paid from plan assets. It's an effective and inexpensive way to keep tabs on the plan providers. Not reviewing the work of the plan providers by an ERISA attorney or retirement plan consultant is asking for trouble.

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