When 401(k) Plan Sponsors Have To Say No

By Ary Rosenbaum, Esq.

When I was a kid, I was rather shy. It certainly didn't help that my parents were domineering. Even as an adult, I would always try to be agreeable and try to get along by not saying no. For the past 14 years with my practice, I've learned to say no and it's to the point where I've become the second coming of Dr. No. As a 401(k) plan sponsor, you want to be agreeable and get along with both participants and plan providers, but there are times when you just have to say no. This is what the article is all about.

You can't please everyone.

As an ERISA attorney for the past 26 years, I've had to say no a lot. It usually is for a 401(k) plan sponsor who wants to do something that they're not supposed to do or can't do. The company wants to buy a building for their business and use assets from the 401(k) plan, that's a big no from me, dog because that is a prohibited transaction that violates both the Internal Revenue Code and ERISA (the Employee Retirement Income Security Act of 1974). So I often have to say no, either to plan sponsors or plan providers because the rules are the rules are the rules. As a 401(k) plan sponsor, you're a plan fiduciary, which requires the highest duty of care in law and equity. You have to exercise that fiduciary prudently. So there are many times that you will have to say no because if you say yes, you might put yourself in harm's way. That harm could be an ERISA litigator, but more likely an Internal Revenue Service (IRS) and Department of Labor (DOL) audit. The 401(k) plan you set up is an employee benefit, used to recruit and retain employees. Remember that fiduciary liability can involve potential personal liability. There are needs you have to say no to preserve your piggy bank. You can't please everyone and there are times, where you have to say no to keep yourself and your plan participants out of harm's way.

Paying plan providers more than they're supposed to.

When I worked for three years at two law firms, the thing I hated was that I had to charge my clients by the hour. I always believed that charging clients by the hour, enticed lawyers to fudge their hours. I know this because a debt lawyer wanted to charge me for a half hour of work for trying to figure out how he could get money from the third-party administrator (TPA) that owed me money, even though it took a minute for me to tell him. So when I started my practice, I decided like my work as an ERISA attorney at a TPA, fees should be flat. I state a fee in my engagement letter, so a client won't have a surprise at the end of the month. What they are quoted is what they will pay. Most of the time, my fee estimate is on point, and I'm not going to do more work to make that fee an albatross to me. If my work on a project exceeds the fee I quoted to the client, I would never go to the client and ask for more money. My word is my bond, so I have to live with the fee I quote. So when a plan provider does that to you, where they want to pierce a fee cap that they proposed, my answer is no. Sure, plan providers can always increase their fees from year to year, but I think it's a breach of fiduciary duty to pay more than the plan provider originally quoted for that specific plan year. I had a client where the auditor proposed a $50,000 fee cap and without an agreement, sent bills for another $30,000. I told the plan sponsor that it could be as perceived as a breach of fiduciary duty if they paid those bills. That was the same

advice I gave to a 401(k) plan sponsor who wanted me to compensate the plan for the TPA overpaying the plan's financial advisors. It's absurd that as a plan administrator, I should have paid the fees that the TPA overpaid. What was more galling was the financial advisors who insisted they should keep the fee. I told the plan sponsor that if they paid the advisors more than they were entitled to and the advisors kept the fee, they would be both violating their duties as fiduciaries to the plan. I told them it would be my duty to report this matter to the DOL. Needless to say, the advisor returned the excess fee. Again, a plan provider can ask for a fee increase (we all know about inflation), they just shouldn't try to pierce an agreed-upon price for services for the specific plan year.

The 401(k) plan isn't a hiring hall for friends and relatives.

A "nepo baby" is a person who has achieved success or opportunities due to their family connections, especially in a similar or related career as their parent. We often see nepotism in family-run businesses, especially law firms where a named partner tries to push one of their children as a partner. We see that in Hollywood, except I don't consider Academy Award Winner Jamie Lee Curtis as a nepo baby, because she's a bigger star than Tony Curtis or Janet Leigh, ever was. Nepotism and cronyism are also practiced in a lot of local political jobs where I live on Long Island. What you can't do as a plan sponsor is use your 401(k) plan as a hiring hall for friends or family. The Human Resources Director has a spouse as a financial advisor, which is great and there are a lot of 401(k) plans they can work on. They just shouldn't work on yours. Selecting plan providers has to be an above-board process, this can't be like the Oceanside Union Free School District Board of Education doling out jobs to friends and family. It's not prudent to hire someone, just because they're juiced in. That's not just about hiring friends and family, it means not hiring the bank as your financial advisor or custodian because they hold your line of credit. The 401(k) plan is for the exclusive benefit of plan participants. Using the plan in any way to benefit you is a prohibited transaction. So selecting providers has to be prudent and what is right for the plan and participants, not what is right for you.

Sometimes, you have to say no to participants.

The rules are the rules are the rules. I'm a stickler for the rules and I have had needless fights with friends, family, and people in business because I'm a stickler for the rules and what's fair. I once pushed myself out of power at synagogue because I fought a friend, and fellow member, from getting a job there, that they weren't qualified for. That is why I call myself, The Last Boy Scout, like the Bruce Willis character in the movie. Either the rules mean something or they don't. Retirement plans are qualified plans, that need to abide by the rules and regulations promulgated by the Internal Revenue Code or ERISA. So there will be times when participants may ask you to bend the rules so that they can get a benefit or a distribution, and you will have to say no. Offering a benefit, right, or feature in the 401(k) plan that discriminates in favor of a Highly Compensated Employee is a hard no. So if someone comes up with the idea that only the partners of the law firm should have access to a Self Directed Brokerage Account (I still chuckle that my old law firm with ERISA partners allowed this), you need to be the voice of reason, and say no. The reason you say no is because it violates the benefits, rights, and features test. As a child who was told no a lot, I don't say no to my children. Yet, if something they ask is highly inappropriate or illegal, I'm going to say no and I have said no. There are times when participants will give you a sob story on why they need the money from the plan. If they can't meet the definition of hardship and can't afford to take out a loan, you can't collude with them to get a distribution. For example, firing a participant to get a distribution, and immediately rehiring them is a problem. So when it comes time to preserve the tax qualification of your plan and avoid potential liability, you have to say no. I had to say no to a hardship from a participant who was in jail (that's not a criterion for hardship, even though being at a local jail can be a hardship) or a beneficiary who killed a participant. You may get some oddball requests like I do, but you have to say no when you have to.

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