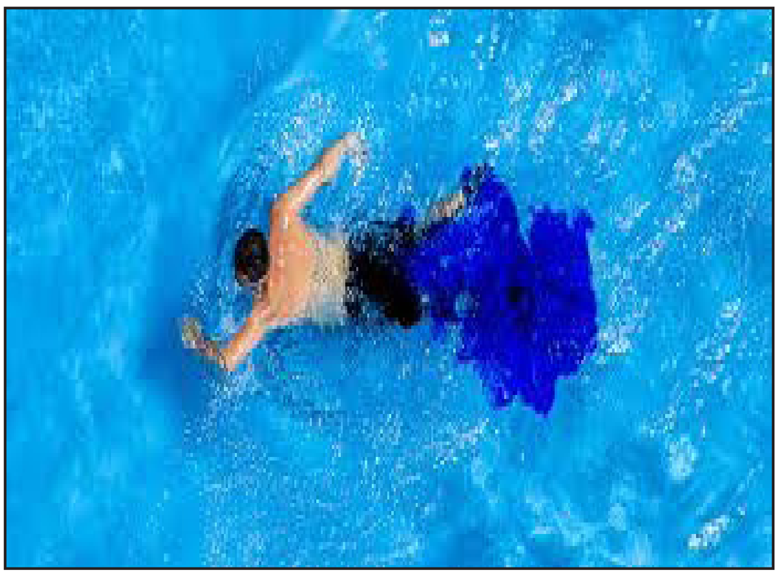
The $3 Million Myth: Why Small 401(k) Plans Need Big-Plan Thinking

By Ary Rosenbaum, Esq.

When we were kids, the world was full of warnings that sounded half ridiculous, half terrifying. "If you pick that wart, it'll spread all over your hand." "Don't pee in the pool, you'll turn the water blue and everyone will know." "Crack your knuckles and you'll get arthritis." "Eat your vegetables or you'll never grow." As adults, we learned something important about these warnings: even when the literal message wasn't entirely true, the lesson behind it usually was. Picking wounds can cause infection. Pool hygiene matters. Neglecting your diet has consequences. Childhood myths were a primitive form of risk management, imperfect, exaggerated, but rooted in the idea that small acts, done carelessly, can lead to bigger problems. And in many ways, nothing has changed. Only now, the myths come dressed in business casual and sit in the conference rooms of small 401(k) plan sponsors.



The Myths We Tell Ourselves as Plan Sponsors

Just as parents once convinced us that swallowing gum took seven years to digest, small employers have convinced themselves of a myth so persistent that it's practically a rite of passage in the retirement plan world: "My plan is small, nobody cares." I've heard every variation of it: "We only have $3 million in assets. We're not even on the radar." "We're too small to get sued." "We don't need formal governance, that's for the big guys." "With only a few participants, the risk is low." This mindset is the grown-up version of believing that lifeguards can see pee in a pool because of a magic chemical that turns the water purple. Comforting, maybe. Absolutely untrue. The truth is simple: ERISA doesn't come with a size exemption. A $3 million plan has the same fiduciary obligations as a $300 million plan. If anything, small plans are more vulnerable because they often operate informally, with fewer resources, more operational mistakes, and a dangerous reliance on "we've always done it this way." The $3 Million Myth isn't just wrong, it's costly.

Why "Small" Doesn't Mean "Safe"

A 401(k) plan is a trust. A legal entity. A regulated structure with fiduciary duties attached to every decision, written or unwritten. Whether the plan covers 10 people or 10,000, the obligation is the same: act prudently; pay reasonable fees; monitor investments; document decisions; deposit deferrals timely; and follow the plan document. None of this depends on asset size. None of it gets waived because you have fewer employees. None of it disappears because you assume you're "too small" to catch attention. And here's the uncomfortable reality: Small plans make the most mistakes; late deposits, inconsistent eligibility, sloppy hardship reviews, no investment monitoring, vague or nonexistent minutes, outdated plan documents, and service providers selected on gut feeling instead of due diligence. It's not malicious. It's not reckless. It's simply what happens when people believe myths instead of responsibilities.

The Real Costs of a Small-Plan Mistake

Think back to the warnings of childhood. The consequences were always larger than the small act that caused them. Pick a scab today, and suddenly we were told our arm might fall off. In the 401(k) world, the consequences aren't exaggerated. They are real: late deposits become prohibited transactions; high fees become lost savings for participants; poorly monitored investments become years of underperformance; lack of documentation becomes a nightmare when auditors ask, "Can you show us?" Plan document failures result in expensive corrections and penalties. A $3 million plan with ten employees is just as capable of making costly errors as a $30 million plan with a hundred employees. The difference is that small plans usually have less structure, less oversight, and less formal governance, a perfect storm for trouble.

The Mindset Shift: Treat Your Small Plan Like a Big One

Once you admit that "small" doesn't free you from responsibility, the path becomes clear.

1. Build Actual Governance — Not Shoe-Box Governance

Many small plans suffer from what I call "shoe-box compliance": a folder full of outdated forms, unsigned agreements, old fee disclosures, and no real structure. Instead, create: a fiduciary governance charter; an annual calendar for reviewing the plan; clear roles for fiduciaries and service providers; minutes from every meeting, even short ones; and a checklist for deposits, loans, notices, and investments. A small plan without governance is like a kid convinced that knuckle-cracking leads to arthritis, acting on a belief instead of facts.

2. Monitor Your Fees Like It Matters — Because It Does

Small plans often pay disproportionately high fees because no one is benchmarking. Fees don't become "reasonable" simply because the plan is small. They become reasonable when you prove they are. When was the last time you: Compared your plan's costs to similar plans? Reviewed share classes? Evaluated recordkeeping alternatives? Checked whether revenue sharing is inflating costs? If the answer is "never" or "years ago," you're operating on another myth: "Small plans can't get better pricing." You can — if you actually look.

3. Review Your Investments — Even If You Use Target-Date Funds

Many small employers assume that picking one set of target-date funds is enough to eliminate oversight. It's not. You still must: review performance; evaluate glide paths; compare fees; confirm suitability for your workforce; identify chronic underperformers; and document decisions. Small plans that don't monitor investments are the adult equivalent of believing that swallowing watermelon seeds makes one grow melons in the stomach.

4. Document Everything , Not When It's Convenient

ERISA cares about process, not memory. If you made a prudent decision but didn't write it down, it may as well have never happened. Documentation protects you from: lawsuits; regulatory scrutiny; participant complaints; vendor disputes; and failing to recall decisions made years late. Your fiduciary file should include: minutes; fee reviews; investment reports; service agreements; provider evaluations; an evidence of disclosures sent to participants. In other words, proof that you behave like a responsible adult, not a child who swears someone else made the mess.

Why Small Plans Actually Carry More Risk

Here's the irony: The smaller the plan, the more likely it is to have: operational errors; missing or incomplete paperwork; inconsistent contributions; incorrect eligibility tracking; outdated plan amendments; improper loan or hardship approvals; and fiduciaries who don't know they are fiduciaries. Large plans have committees, consultants, auditors, and processes. Small plans have assumptions. And assumptions are where trouble lives. Just like childhood myths, these beliefs feel comforting. But comfort is not compliance.

A Practical Action Plan for Small-Plan Fiduciaries

Think of this as the grown-up version of "wash your hands before dinner."

1. Create a Formal Governance Structure

Even if it's a one-person committee, structure it.

2. Benchmark Fees Every Year

Not once a decade. Annually.

3. Review Investments Quarterly

Simple lineups still require real oversight.

4. Keep a Fiduciary File

Minutes, decisions, disclosures, reviews — all of it.

5. Confirm Operational Compliance

Deferrals, eligibility, loans, hardships, notices.

6. Evaluate Your Service Providers

Don't stick with a vendor because "we've always used them."

7. Update Your Plan Document

Make sure operations match the text — not memories.

8. Act as If You'll Be Audited Tomorrow

Because you might be.

The Real Moral: Don't Believe Everything You Heard Growing Up

The myths of childhood were charming. The myths of 401(k) plan sponsorship are not. A $3 million plan isn't a toy. It isn't protected by size. It isn't immune from audits, complaints, or consequences. It's a real trust, with real fiduciaries, who carry real responsibilities. Just like the childhood warnings that helped shape our habits, this one should stick with you: Small plans don't get a free pass. Small plans need big-plan discipline. If anything, small plans need more discipline because they have fewer resources and less room for error. You don't need to scare your inner child. You just need to stop believing the myth — and start acting like the fiduciary you already are.

THE ROSENBAUM LAW FIRM P.C.

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

http://www.therosenbaumlawfirm.com