Don't Let Your 401(k) Plan Turn Into A Natural Disaster

By Ary Rosenbaum, Esq.

Having survived Hurricane Sandy with 5 feet of water downstairs, I've had my fill of natural disasters. Whether it's climate change or not, the weather is more unstable than ever before. Whether it's 70 degrees by me in November or dastardly heavy storms, I know weather has become extreme, and natural disasters are becoming more frequent, especially flooding. Dealing with where you live, like right by a fault line, natural disasters may be unavoidable. As a 401(k) plan sponsor, you can avoid your plan becoming a natural disaster by taking care of a few things around your plan.

First, you have to get your act together.

Before you even actually start a 401(k) plan or hire a plan provider, you need to get your act together. That means treating the 401(k) plan less like a nuisance and something that you need to be responsible for and handle with care. Too many small and medium plan sponsors just have one person in charge for a 401(k) plan and I often find that it's a problem especially if that one person doesn't know what they're doing or when that person leaves the company with no transition in getting the replacement up on what is going on with a 401(k) plan. My advice is that you set up a 401(k) committee of a manageable group of important decision-makers. Too often, employers create a 401(k) committee with too many members, like my old synagogue's Board of Trustees. Like that Board of Trustees, too many cooks in the kitchen will guarantee you that nothing will be baked. You need a 401(k) committee that meets regularly, especially with the financial advisor on the plan (which will be discussed later). You can't treat your 401(k) plan like a trip to the dentist taking out the trash or any other chore you want to avoid.

Be Proactive, Rather Than Reactive

My biggest complaint about plan sponsors is that they're not proactive and just reactive. That means they won't bother to discover a problem and only get help when something breaks. I know this from experience as I have a plan review called The Retirement Plan Tune-Up. Ten years of offering it and I can count on two hands how many plan sponsors opted for it even though they could pay for it from plan assets. The point is that plan sponsors would rather discover problems after they've happened instead of nipping things in the bud proactively. The problem that you need to understand is that detecting issues early will allow you to make more cost-effective corrections. If you only fix problems long after they occur, it ends up being more costly because of the length of time and the corrections that might not be allowed because of the time that has elapsed. In terms of many plan providers, self-correction is an option that might be unavailable to you if you wait too long. You might be forced to make a voluntary correction program application that is going to cost thousands and thousands more in legal and correction program fees that you could have avoided with self-correction. The health of your 401(k) plan is similar to your health, if you wait too long to diagnose a problem, the problem just becomes bigger and harder to fix.

Hire a good TPA

The most important plan provider that you can hire is a good third-party administrator (TPA). There are a variety of reasons you should consider in hiring a TPA, but the most important reason is that they can do a competent job. For most plan compliance errors, the difference is usually the quality of a TPA. A good TPA makes fewer errors than a bad one. The problem with a

TPA is that while they may make errors, you're on the hook as a plan fiduciary to get those problems fixed. There are so many compliance points that a 401(k) plan has to complete to remain qualified, which means there are so many ways a mistake can be made. So it's for your benefit to hire a good TPA that can help you get away from harm's way. While a plan sponsor and other providers can be responsible for errors they commit, I have seen too many 401(k) plans have such expensive compliance headaches and the reason was that the incumbent TPA wasn't up to the task of being a TPA. In addition, a good TPA will help design a benefit formula that could help you maximize contributions to highly compensated employees while maintaining a required contribution to non-highly compensated employees. That design might be new comparability, there might be a safe harbor 401(k) contribution, or there might be a formula in conjunction with a defined benefit/cash balance plan. What you need to know is that there is more to life than salary deferral contributions and pro-rata contributions. Good TPAs are creative when it comes to plan design and that will help you with your wallet. You need to understand the value of a good TPA and how they can save you money through a lack of compliance errors and a plan design that is the right fit for your company's demographics and wallet.

Hire a good financial advisor.

Too many plan sponsors think that all financial advisors do is just pick investment options for a 401(k) plan. Well, the mediocre advisors just do that. A good financial advisor will help a plan sponsor minimize their fiduciary liability by helping a plan sponsor manage the fiduciary process of the plan. That means helping the plan sponsor develop an investment policy statement, meeting regularly with the plan sponsor, and providing enough information to participants to make their own investment decisions. Any advisor can develop a decent fund lineup, you need to hire an advisor who knows about 401(k) plans. A good financial advisor who has a background in retirement plans will help you not only in managing the fiduciary process but also in dealing with a TPA. A good financial advisor will serve as your plan's ombudsman, even helping you in areas that have nothing to do with the financial management of the plan.

Hire an ERISA fiduciary

A TPA not serving in a fiduciary capacity will leave you on the hook for any liability concerning their mistakes. A financial advisor who is a broker (not a registered investment advisor) isn't likely serving in a fiduciary capacity either. You can have a greater level of protection for your fiduciary liability by delegating that responsibility to providers who will take on that role. Instead of just having a TPA, you can have an ERISA §3(16) administrator (either the TPA or another provider) who will assume the liability for the day-to-day administration of your 401(k) plan. You can also hire a registered investment advisor or a bank or trust company to serve as an ERISA §3(38) fiduciary who will assume the liability for managing the fiduciary process of the plan. That means they will select the investments and educate the participants without your involvement. While these ERISA fiduciaries will assume the liability for the decisions they make on the plan's behalf, keep in mind that you still retain some liability for hiring these providers and you will bear the brunt if these providers are incompetent or are crooks. Whether hiring these providers is considered a fiduciary or settlor function, you're still responsible for hiring them.

Get proper insurance

Your 401(k) plan must have an ERISA bond to protect the plan against the theft of plan assets by fiduciaries. Make sure it's an ERISA bond and not some general crime policy. While an ERISA bond is legally required, a fiduciary liability policy is not. A fiduciary liability policy isn't like an ERISA bond. A fiduciary liability policy doesn't protect plan assets, it protects fiduciaries such as the plan sponsor, the trustees, and those with authority over the plan. It's important because liability claims against plan fiduciaries may result in personal liability for those plan decision-makers. So these fiduciaries need to get a shield of protection in litigation against the 401(k) plan. If your insurance salesperson doesn't know about fiduciary liability policies, find someone who does.

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