How To Make Your Life Easier As A 401(k) Plan Sponsor

By Ary Rosenbaum, Esq.

Life is hard, so is being a 401(k) plan sponsor. It's a challenging job and there are many ways you can limit those challenges. There are opportunities to make your life easier as a plan sponsor, but you need to know what it all means and whether it makes your life easier.

The real story about plan delegation

As a 401(k) plan sponsor, you're a plan fiduciary, and being a fiduciary requires the highest standard of care in equity and law. I've written that phrase so many times, that I can probably recite that in my sleep. While you always have the responsibility to run your plan your way, there are two major problems. The first problem is that unless you are in the retirement plan industry, you are going to have to delegate the administration of your plan to third-party providers. The second problem is that by delegating the administration of your plan to a third-party administrator (TPA) or financial advisor, you haven't delegated your responsibility. So by hiring a regular TPA and/or financial advisor, you are ultimately responsible for their work. So if your TPA has as much administration background as my teenage kids or your advisor is the second coming of Bernie Madoff, you are still going to be at fault. While you can delegate some of your administrative duties in this arrangement, you are still on the hook for liability if your third-party providers are incompetent or crooked. With the increase in litigation against 401(k) plan sponsors, there is a need for many plan sponsors who want to eliminate as much as possible their fiduciary liability of running a retirement plan. So that need is met by an outsourcing solution, which can be handled by other providers who must designate their role as plan fiduciaries for you to divest yourself of most of that fiduciary responsibility.

Outsourcing fiduciary functions

The method of outsourcing your fiduciary responsibility isn't new. The fiduciaries who will offer these types of outsourcing services have a special designation for their service and you need to know the differences between the levels of services to make sure that you are buying what you think you are buying and that you are getting the level of protection that you think you are getting because there are enough people in the retirement plan industry who will sell you a nickel and tell you it's a dime. It should be noted that with this outsourcing model, you could eliminate almost all of your liability when it comes to your plan's administration and investments. I said almost all because hiring these providers is a fiduciary function, so if one of these fiduciaries is incompetent, you're still potentially on the hook for some liability for hiring that incompetent fiduciary. Outsourcing isn't the solution for everybody because it requires a surrender of control and many plan sponsors like you want to control their plan's direction. However, it should be noted that you can outsource on an a la carte basis, you can outsource your investment control, but keep the responsibility of plan administration in-house or vice-versa.

ERISA 3(16) administrator

The TPA you hire is responsible for your plan's compliance, record-keeping, and tax filing. You may have two companies do the task such as a separate TPA and record-keeper, but it's the same tasks being completed by a tandem. Notice that a TPA is a third party, which means that you as a plan sponsor are ultimately responsible for any errors or issues dealing with the day-to-day administration of your Plan. If the TPA fails to file Form 5500 guess who is responsible for cleaning up the mess or paying those huge penalties? You, the plan's sponsor. So if you want to delegate that administration responsibility, what do you do? You hire an ERISA §3(16) administrator. So what's the big deal? The "Plan Administrator" of a qualified retirement plan is defined in section 3(16) of ERISA. The Plan Administrator is not the same as a "Third Party Administrator" because a Section 3(16) administrator is a "first party" administrator. The Plan Administrator has the job of ensuring that all filings with the federal government (form 5500, etc.) are timely manner; making the required and important disclosures to plan participants; hiring plan service providers if no other fiduciary has that responsibility, and fulfilling other responsibilities as outlined in plan documents and their contract. The ERISA §3(16) administrator is a plan

fiduciary and assumes the liability that comes with it. However, they have no direction in selecting the plan investments. When it comes to hiring a §3(16) administrator, a contract with any of these potential providers should be fully reviewed to delineate which task they will assume and which tasks you will assume. For example, a §3(16) administrator may or may not take on the task of making sure that 401(k) salary deferrals from employees are remitted on a timely basis. Needless to say, that is an extremely important task and you need to be sure which tasks this fiduciary will assume and take off your plate.

ERISA §3(38) Fiduciary

An ERISA §3(38) fiduciary is the ERISA defined "Investment Manager", which is defined in Section 3(38) of ERISA. The Investment Manager becomes "solely" responsible for the selection; monitoring and replacement of plan investment options, as well as all aspects of the fiduciary process such as developing the IPS and offering participant education. So in this structure, the Plan Sponsor and other plan fiduciaries are relieved of the responsibility for the Investment Manager's decisions. However, the plan sponsor retains a residual duty to prudently select the Investment Manager and make sure they are carrying out their appointed duties. Also, the §3(38) fiduciary has no responsibility in dealing with the plan's administration. So while a §3(38) fiduciary is the Cadillac of investment fiduciaries, they are the Yugo of fiduciaries when it comes to the day-to-day running of the Plan. You should always review a contract from any potential §3(38) fiduciary. Still, it should be noted that there is no such thing as a "limited scope" ERISA §3(38) fiduciary because all ERISA-defined investment managers have full discretionary authority over the fiduciary process.

Pooled Employer Plan (PEP)

Since 2021, the Internal Revenue Code has allowed a new Multiple Employer Plan (MEP) called a Pooled Employer Plan (PEP). MEPs have been around as long as retirement plans are around, but in 2012, the Department of Labor required commonality among companies that adopted the MEP to be considered a single plan for ERISA purposes. The PEP eliminates that commonality requirement and essentially eliminates the fiduciary liability for a company that becomes part of a PEP as that role belongs to a Pooled Plan Provider. MEPs were never clear as to the extent of the liability of an adopting employer. Still, a PEP is pretty clear as to eliminating fiduciary liability for a company that adopts one. However, choosing a PEP and a pooled plan provider is a liability that an adopting employer can't shed. As a single employer plan sponsor, joining a PEP may not be ideal if it doesn't offer the cost savings that should go with adding your plan assets with the other assets of other companies. In addition, by joining a PEP, you're giving up control, and that not might be something you want. PEPs may be a great way to eliminate fiduciary liability because you wouldn't be responsible for the day-to-day administration of the plan or filing a Form 5500, but there may be no cost savings if the PEP isn't big enough, which is supposed to be one of the attractions of joining a PEP.

Having Participants certify hardship distributions

401(k) plans can offer hardship distributions to participants. Since it's participant money, I have always advocated that 401(k) plans offer it. Hardship distributions are for important reasons like burial expenses, medical expenses, educational expenses, to prevent foreclosure/eviction, or other life-important events. While many believe that participants shouldn't tap their accounts in these instances, we should allow participants to have the free will to make those choices when they need to. Up until recently, plan sponsors had to certify a participant's request for a hardship had a bonafide reason, according to regulations. As an ERISA attorney, I have had to approve these requests for clients and I had to tell the participant in jail that being in jail isn't a hardship for purposes of a hardship distribution (it's just a hardship in life). Thanks to a law change by SECURE 2.0, plan sponsors can now establish policies and procedures allowing participants to self-certify that the hardship distribution is being made on account of a deemed immediate and heavy financial need. You're no longer required to collect documentation when approving hardship distributions, which should help streamline the hardship distribution process. However, participants should retain documentation of the need for the distribution, especially if the Internal Revenue Service audits the plan and reviews the hardship distributions made by the plan. I understand why plan sponsors still want to certify hardship requests, but doing that puts the burden on you to make sure they're legitimate. If a participant certifies it, the burden is on them. If they're lying about their hardship request and you have no knowledge of that lie, they will have to deal with any ramifications.

The housekeeping stuff

For almost every task out there, companies are willing to do that work for a fee. If your financial advisors can't provide investment advice or actual investing to participants, companies are willing to do that for fees being charged to the participants who want it. There are also companies willing to take care of all those notices for you that you need to disseminate. My friends at Plan Notice are good at that. As with any, cost is the overriding concern to you and the participants.

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