Remember That Your 401(k) Plan Is An Employee Benefit

By Ary Rosenbaum, Esq.

So often, people forget why something was implemented or done. They lose their way. That's how I felt as a synagogue Vice President for about a year. As a 27-year ERISA attorney, I have encountered so many 401(k) plan sponsors who have forgotten why they implemented their plans to begin with. This article is to remember that ideal.

A 401(k) plan is an employee benefit

Yes, sole proprietors and their spouses can have Solo 401(k) plans that do not fall under the protection of the Employee Retirement Income Security Act (ERISA). If you have an employee who isn't a spouse, the plan is subject to ERISA. The idea behind offering a 401(k) plan when you have employees is that it's an employee benefit. It's no different than health insurance, access to a credit union, and free milk and coffee. A 401(k) plan is supposed to be a tool to recruit and retain employees. You will be surprised how many 401(k) plan sponsors think that. Sure, it's a great mechanism to save money if you're an owner-employee, but if you have employees, never forget it's an employee benefit.

It's an exclusive benefit for 401(k) participants

I live in a village where the school district is a community hiring hall by the school board. We have more school board members with their children on school district payroll, than board members with children in our schools. Your 401(k) plan should not be a hiring hall for your friends and family. The 401(k) plan is for the exclusive benefit of the plan participants, it's not to wet your beak or the beak of the people you know (obligatory The Godfather Part II Don Fanucci reference).

Run the plan well

You wouldn't eat at a restaurant with a lot of issues in the kitchen, especially if it's dirty. Those grades from the Department of Health are a good indicator of that. If you have a 401(k) plan, ensure it runs well. It's like a public restroom, make sure it's clean. When I worked at a Fakakta law firm with an ERISA practice, I was a little alarmed when the Human Resources Director (and co-trustee) asked me to review the plan. The 401(k) plan had no advisor and didn't have plan investments reviewed for 10 years. They also provided zero investment education to plan participants. That 401(k) plan was a potential liability trap for the law firm. Even as important, it was a poor benefit for employees even if they gave us a 5% annual, fully vested, profit-sharing contribution. It's not enough to set up a plan, you have to run it well. I always like a 401(k) plan for a car, it needs constant upkeep to make it run efficiently and well.

The eligibility problem

A lot of 401(k) plans have an eligibility requirement of one year of service and the attainment of age 21. I understand why 401(k) plan sponsors may want to have a one-year wait before they fund employer contributions to new employees, as well as excluding part-time employees. However, I don't understand why plan sponsors restrict new employees from deferring in a 401(k) plan. The reason I don't understand it is because compliance testing for salary deferrals allows the plan to continue the ADP discrimination test as if the plan used a year of service and age 21 requirement (I call it 21 and 1). I understand that plan providers and plan sponsors want to have that requirement to avoid small account balances if the company has a huge turnover with new employees. I suspect that if an employee has a high turnover among new employees, the 401(k) plan is the least of their plans. I will say as someone who was an employee once and a bit of a malcontent, I would be hesitant to accept a job offer when I was currently in a 401(k) plan, that would require a Year of Service. Even people who aren't malcontents would have a tough time accepting a job offer for a one-year wait if saving for retirement is a big deal to them. The maximum deferral savings limit for a 401(k) is $23,500 in 2025 and $31,000 if you're 50 or over. That's a lot of retirement savings to possibly forego to accept a new job offer. Again, you should have a service requirement for employer contributions, but you should let new employees defer with a month requirement or no service requirement at all. You should always look for the best and brightest in new hires and a 401(k) plan with a one-year wait could get in the way of getting the best and the brightest.

Let them be aware

I worked at places and I always joked as employees, we were the last to know anything. There was a place or two I worked at, where I joked there would be a sign on the front door that we were closed for good, and that was the clue we no longer had jobs. If things are going on with the 401(k) plan, let employees be aware. I worked for a Third Party Administration (TPA) firm and we worked with about four platforms. Our 401(k) plan was on a platform run by one of my favorite mutual fund companies. One platform we had plans on, we were no longer putting new clients on there, because it was being run by an insurance company. In a pre-fee disclosure 401(k) world, this insurance company was charging 269 basis points annually (that is 2.69% of the 401(k) balance) on some plans we had with outdated contracts. Since we were not selling many plans on this platform, we were threatened by the insurance company that we would lose our premier pricing on this platform. So the powers that be, placed our $4.3 million 401(k) plan on the insurance company-based platform. Most employees were unaware of the change until it was done. I knew the plans beforehand and as a malcontent, one of the bosses was trying to tell me this was a good thing, except all the advisors we worked with, and all the new 401(k) clients we worked with, avoided that insurance company platform like it was the plague. ERISA requires the furnishing of required notices, including fee disclosure, and a Summary Plan Description. However, I still think outside of these required notices, it helps with morale if you let plan sponsors know what is going on.

Hold those enrollment and education meetings

Back in the old days, 401(k) plan sponsors would try to avoid having their advisors onsite to conduct enrollment and education meetings. Many 401(k) plan sponsors resented the loss of work hours for an employee benefit. Now, most 401(k) plan sponsors are finally understanding that the need for these meetings is as important as limiting their liability, as well as helping employees out. There was a misconception out there about participant direction of investment and the elimination of liability for 401(k) plan sponsors. ERISA §404(c) doesn't offer blanket liability protection for 401(k) plan sponsors. The liability protection is dependent on giving participants enough information to make informed investment decisions. So if you're going to run the 401(k) plan like my old law firm did before I helped fix it, you will get zero protection. So that's why you should hold those participant enrollment and education meetings and meet regularly with your advisor to review the plan investment lineup.

Ask for their input

I am not suggesting you get employee representatives on the 401(k) committee, most employees probably don't want the decision-making role, done for gratis. However, I think you should always ask for employees' input in running the plan. Whether it's a survey or a suggestion box, ask for their input, and review it. Loyalty is a two-way street. If you want your employees to be loyal to you, be loyal to them, and respect their opinions.

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