



ARTICLE 3.2
OPERATIONAL EFFICIENCY:
Accuracy

Contributor

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BMO Defined Contribution IQ™: Accuracy (Part 2 of 3 on Operational Efficiency)

In 1711, Alexander Pope penned, “To err is human; to forgive, divine.”¹ And while that may be a perfectly reasonable plan for leading a good life, it has little application for someone acting in a fiduciary capacity.

Errors expose plan sponsors to liability

In the context of a defined contribution retirement plan, errors can lead to serious, adverse consequences. They can erode participant confidence, which can negatively impact participation. They cause delays in processing, which can also cause participants to lose faith in their employer-sponsored retirement plan. Some mistakes result in operational failures, which can lead to financial losses. Worse yet, errors can result in sanctions, fines or levies against the plan, its sponsor or its fiduciaries.

Ten most common mistakes

Though 401(k) plans are somewhat commonplace, they can be very complex in design and are subject to a multitude of regulations contained in ERISA and the Internal Revenue Code. Regulations require that qualified plans pass nondiscrimination rules and top-heavy testing, and that employer and employee contributions are limited to certain percentages or dollar amounts, which can change annually. In addition, each plan is required to operate within the guidelines described by its plan document, which adds even more layers for potential mistakes.² As a consequence, errors can occur with not-so-surprising regularity.³

And if those plan-level requirements are not onerous enough, plan sponsors are periodically required to adopt amendments to comply with new regulations and legislation—and these amendments must often be adopted within a short, specified time period. What’s more, each plan sponsor is required by law to restate their entire plan document every five to seven years.⁴

What’s your DC IQ?

To help plan sponsors identify intelligently designed and thoughtfully implemented plans, BMO Retirement Services has identified nine key DC IQ attributes across three broad categories:

PLAN DESIGN

PARTICIPANT UTILIZATION

OPERATIONAL EFFICIENCY ●

Within operational efficiency, we examine **timeliness**, **accuracy** and **value**.



Types of errors

According to the IRS,⁵ the top ten mistakes they see when reviewing defined contribution plans are:

1. Failure to update the plan document
2. Failure to follow plan provisions
3. Using an incorrect definition of compensation
4. Incorrect allocation of employer match
5. Failure to correct the ADP/ACP nondiscrimination testing
6. Failure to include all eligible employees
7. Failure to limit elective deferrals to the annual deferral limit
8. Late deposit elective deferrals
9. Failure to administer participant loans properly
10. Incorrect administration of hardship distributions

The IRS publication also lays out the appropriate voluntary correction methodology for each of the mistakes listed.

Errors must be corrected through approved methods

The IRS does not rely exclusively on plan sponsors' voluntary compliance with rules and regulations. The agency identifies many errors through publicly available 5500 reports.⁶ The IRS and the DOL also conduct field investigations, which can be either the result of random selection or triggered by participant complaints.

If such audits uncover significant errors, the IRS could disqualify the plan, which is equivalent to the death penalty for the plan.⁷ All contributions would lose their tax-deferred status, and taxes would become due to the IRS. Thankfully, that result is very rare.

However, if the IRS or DOL does find an error that the plan sponsor has not self-corrected using an approved method, any fines or penalties assessed will be much higher than they would have been for self-corrected mistakes.⁸

It is possible for even the best service providers to err occasionally in administering a plan. And while it may be unreasonable to have zero tolerance for errors, advisors and plan sponsors should feel comfortable requesting a formal review of any significant errors.

In that review process, the advisor and plan sponsor should consider the following:

1. Does the service provider own up to the error, or do they make excuses for it?
2. If the mistake resulted in a loss to the plan or a regulatory fine, does the service provider commit to making the plan or plan fiduciaries whole?

3. What steps does the provider propose to prevent a similar mistake from happening in the future? Are those steps reasonable?

Based on the answers to these questions, plan fiduciaries need to decide whether they still have confidence in the service provider to administer their plan assets. If the answer is no, or if the errors are frequent or significant, it may be time to place the plan out for bid.⁹

A step-by-step process for preventing future mistakes

When an error does occur, it is important to correct the error, understand the root cause and take the appropriate actions to prevent reoccurrence. To significantly reduce the potential for future mistakes, fiduciaries should take the following steps:

1. Understand the terms of your plan document
2. Properly maintain your plan document
3. Familiarize yourself with the rules around administering plan loans and hardship withdrawals
4. Train new payroll or human resource employees on points (1) and (2) above
5. Understand the terms of your service agreement and how your service provider commits to support you on these issues
6. Meet at least annually with your service provider to review your plan document and to discuss any changes that might reduce the potential for future errors
7. Be sure to forward elective deferrals to your trustee as soon after the payroll date as possible¹⁰

By following these steps, plan sponsors and their advisors can reduce the potential for errors and uncover errors sooner — which will improve plan compliance and reduce the cost of operation over the long term.

¹ <http://www.quotecounterquote.com/2010/12/to-err-is-human-to-forgive-divine.html>

² <http://www.jdsupra.com/legalnews/how-to-fix-a-401k-plans-foul-ups-ble-41396/>

³ <http://www.benefitspro.com/2014/02/04/dol-retirement-plan-non-compliance-fines-up-33-per>

⁴ <https://www.noblepension.com/PDFs/AdvisorEducation/401kErrorPlanProviderChange.pdf>

⁵ http://www.irs.gov/pub/irs-tege/401k_mistakes.pdf

⁶ <http://ebn.benefitnews.com/blog/ebviews/10-mistakes-that-may-trigger-a-401k-plan-audit-2744465-1.html>

⁷ <http://www.stoel.com/it-pays-to-fix-401k-plan-mistakes>

⁸ <http://www.jdsupra.com/legalnews/how-to-fix-a-401k-plans-foul-ups-ble-41396/>

⁹ <http://www.jdsupra.com/legalnews/401k-errors-that-suggest-its-time-for-38130/>

¹⁰ <http://www.irs.gov/Retirement-Plans/Late-Deposit-of-Salary-Deferrals-Fixing-Common-Plan-Mistakes>

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