401k|SAFE®

Oh, The Things We've Seen:

A Synopsis of Notable Retirement Plan Problems

Executive Overview

Over the past decade, 70% or more of the plans audited by the Department of Labor were found to have operational deficiencies which led to penalties, fines and/or plan restitutions. (Source DOL EBSA website)

This should be a startling statistic for any employer who sponsors a qualified retirement plan (e.g. 401(k) or 403(b) plan). Since 2011, the Department of Labor (DOL) has conducted a random compliance audit process, meaning that any plan, in any given year, can be audited without cause. How is it that 70% of the plans they audit would have an operational problem leading to fines, penalties or restitution? At a broad level, we believe it is caused by a "vendor disconnect." Many plan sponsors assume that their plan vendors are watching out for what is in the best interests of their plan and plan participants, in other words, serving as a fiduciary for their plan. Although we firmly believe the vendors are genuinely doing their best to service the plan and participants, they generally (unless specifically contracted) do not serve in a fiduciary capacity to your plan, and as such, do not take responsibility for the compliance aspects of your plan. That responsibility is solely yours.

As the sponsor of a qualified plan, you maintain the fiduciary role and responsibility to ensure the plan's investment and operational functions are conducted in the best interests of your plan's participants.

The Employee Retirement Income Security Act of 1974 (ERISA) defines the fiduciary duties for ensuring the plan's investment and operational functions are conducted in the best interests of the plan's participants. It holds plan fiduciaries to a prudent law standard, which means fiduciaries have personal liability for the decisions they make regarding the plan. Having an ongoing, documented process for overseeing the investments and operations of the plan is critical to defending the decisions you make and to avoid the potential compliance problems we often see.

In our twenty-five years as fiduciaries, we often like to think we've seen it all, but we are continually reminded that we haven't. There seems to be a common problem among many employers who sponsor a plan; they simply don't know what they don't know. The common compliance mistakes are not caused by a lack of doing but rather a lack of knowing what to do. This lack of knowing often reflects in a mindset of complacency when it comes to fiduciary oversight and compliance. "This is how we've always done it, and we've never had a problem," is often the response we hear from owners and executives. "Had we known what we should have been doing…" is often the response we hear from owners and executives once they have been audited by the DOL.

The regulatory and legal environment we navigate in today's retirement plan space means you have one of two choices;

1. Take ownership of your fiduciary responsibility, or
2. Engage options to outsource your fiduciary responsibility.

There's no legal mechanism to totally absolve your fiduciary role or liability, but there are options available today to offload a substantial amount of the burden. However, being complacent, and doing nothing, is not a prudent option. This white paper provides brief summaries of some of the notable mistakes we've seen employers make in regards to the oversight of their plan. They are provided not to cause fear, or to make you re-think whether or not to offer a plan to your employees, but more so, to show how some simple mistakes can cause big problems. The good news, and believe me there is good news, is that these mistakes can be corrected, and the plan can operate properly going forward.

Business Decisions Can Impact 401(k) Plans

Motorcycles and 401(k) Plans

Barry and his family are all about motorcycles. They have been selling motorcycles for decades and their dealership was experiencing tremendous growth. That growth presented them opportunities to acquire smaller dealers from time-to-time. Within a few years they owned over a dozen dealerships, and along the way Barry also acquired some additional businesses.

When the family made the decision with their financial advisor to change their 401(k) plan, they decided to outsource their fiduciary oversight to our firm. In our review and due diligence of their current businesses and 401(k) offering, we discovered some problems:

1) Multiple locations with separate 401(k) plans and with different provisions and benefits. One plan provided a Safe Harbor match, another plan had no employer match, another had an annual profit sharing contribution. The was no commonality to the benefits employees were receiving and all of these plans were subject to a common controlled group of ownership.
2) There were businesses with no 401(k) plan, but were part of the common controlled group of ownership.

The clean up process involved amending the plan documents to establish a common set of provisions and a common employer match. It also involved a submission to the Voluntary Correction Program (VCP) to correct the errors. The employees at the businesses without a 401(k) were provided access to join the 401(k) going forward.

How could this have been avoided? If the administration for these plans had been centralized it would be less likely this would have occurred. However, any TPA worth their salt is providing a plan sponsor with an annual checklist to update ownership information and to disclose other businesses. As an employer and sponsor, it is your duty to keep your TPA abreast of any and all material changes in the ownership of the business so they can assess how it would impact the 401(k) plan.

A 401(k) Pest

The owners of this pest control company had a big vision; they were going to build their company by acquiring small, mom and pop, pest control services that were looking for a way to cash out of their business. The strategy worked, and they made several acquisitions within just a few short years. Three of these pest control businesses had existing 401(k) plans and the company continued to operate those plans accordingly to their plan provisions and employer contributions.

When we were engaged by the advisor, the owners wanted to simply merge the assets of all of the plans to one consolidated 401(k). Unfortunately, that was not an option. All of their acquisitions were asset purchases instead of stock purchases, which is common among small businesses. But with an asset purchase the pest control company was simply buying the assets of the acquired business and not taking ownership of the company's stock. Since they didn't legally own the business, they weren't legally the sponsor of the 401(k)'s of the businesses they had acquired. This also prevented them from merging the assets of these plans (a trustee-to-trustee transfer) because they were not the legal trustees of the plans.

The clean up process for this plan sponsor was complex and costly, involving amending plan documents and submitting a VCP correction (the preparation and VCP submission alone was over $10,000). Since all of these plans were subject to annual financial audits as part of their 5500 filing (plans in excess of 100 eligible participants are consider large plan status by the IRS and subject to having audited financial statements produced as part of their 5500 filing) this required corrective audit work as well.

How could this have been avoided? The legal counsel retained to generate the purchase agreements should have inquired about the potential impact of benefit plans, but we commonly find they do not, so again, it is important for you as the plan sponsor to update and disclose to your TPA any material changes to your business. It may seem intrusive, but it could save you from serious problems.

Solar Panels and Lost Employees

A few years ago, this California solar company needed more installers to help meet the demand of their growing business. So when a competing solar company was looking to make a business change, they acquired a large group of their employees. However, they also assumed the 401(k) plan these employees were participating in, along with the terminated participants with balances. This was their first big mistake, they should never have assumed the plan. However, they did and they made a couple of mistakes in the takeover;

1) They never amended the plan or changed the employer identification number (EIN) on the annual 5500 filing. The participants deferring to the plan were being paid under the solar company's EIN, not the EIN stated on the 5500.

2) They didn't immediately address forcing out the participants with balances under $5,000, as allowed in their plan document. There were a lot, and it caused the plan to be subject to an annual plan audit, which was costly.

The erroneous EIN number on the plan was an easy, low cost correction by amending the prior 5500 filings with the correct number. The terminated participants were another issue, because so much time had passed, and these termed participants were never their employees, they were lost. Communicating a force-out process was not possible. However, when we were engaged, using current search services, we were able to locate all but a couple of the terminated participants, and initiate a force-out for approximately forty terminated participants with balances under $5,000.

How could this have been avoided? It was unclear how this happened, but it seems rather clear they had little or no counsel on the acquisition of these employees. The TPA should have questioned this merger of additional employees and more importantly reconciled the two separate plans, but this again shows how a plan sponsor can get into an avoidable problem by simply not knowing they were causing one.

The Plan Drives the Administration

Calculating Time and Money

The CFO of this non-profit focuses his energy on ensuring their organization's mission is properly funded. When it came to calculating the annual employer contribution, he had his method and process for determining the eligibility period for newly eligible participants. However, his calculation was not aligned with the plan's provisions for determining the eligibility period for the employer match.

He had read the plan's provision and interpreted the definition of eligible compensation based on when the employee satisfied eligibility, not based on the entire plan year. In our review with our TPA, we readily agreed the plan provision was not clearly stated, but the eligible compensation was based on the entire plan year, not when the employee had satisfied their eligibility requirements. The TPA conducted a self-correction and the calculation going forward was based on the entire plan year.

How could this have been avoided? The CFO was convinced he was properly calculating the contributions, because he had been doing it this way for several years and it was never questioned. But when the plan moved to our fiduciary service, he had a TPA focused on ensuring the calculations were being done correctly in accordance with the plan's provision.

A Backlog of Plan Audits

A mid-western trucking company began offering a 401(k) plan in 1999. Each year they dutifully signed their Form 5500, indicating the number of participants in the plan. The problem was they filed each year only showing the participants deferring to the plan and didn't include those employees who were eligible, but not deferring.

As their business grew, their eligible participants grew as well and exceeded 100, making them subject to having an annual financial audit conducted with the 5500 filing. In 2017, they decided to engage a new financial advisor who brought us in to discuss the plan. We discovered the 5500 filing problem and the HR director said she was not aware they were required to have the plan audited each year. It was determined the plan, based on the actual eligible participants each year, had become audit status in 2005. This meant the plan had eleven years of previous 5500 filings that should have been filed as a large status plan with an audited financial statement.

This plan is currently working through a correction. Conducting eleven years of prior audits, along with the corrective actions is going to be a costly endeavor, probably well in the six-figures when all is completed.

How could this have been avoided? This is a classic, though extreme, case of a plan sponsor not knowing what they don't know. It's also a classic example of the disconnect between the plan sponsor and the vendors servicing the plan. This company's management is focused on overseeing the logistics of a trucking company, not overseeing the logistics of administering a 401(k) plan and needed a service provider who would monitor the compliance of their plan. Though we haven't seen the history yet, it would seem this problem would have been caught during the year-end non-discrimination testing, but somehow the true eligible participants were never identified.

A Bonus They Didn't Want

The sales manager of this office supply company confronts the payroll manager asking her why the bonuses of his sales reps were being deferred to the 401(k) plan and if she could turn this off in their payroll system. He tells her his reps are complaining to him every time they receive their bonuses and they just don't want their bonuses deferred to the plan. She tells the sales manager that this is a simple fix and she turns off all bonuses from being deferred to the 401(k).

Fast forward fifteen years when we were introduced to this plan sponsor. Their plan document's definition of compensation didn't exclude bonus compensation from being deferred to the 401(k) but they have operated under a company understanding that they would not defer bonuses. We explained a DOL compliance audit would be devastating for them, but the thought of going back and correcting fifteen years of bonuses was overwhelming to the plan sponsor.

With the assistance of the TPA we worked with on the plan, the corrections were made. But there's more to the story. About four months later this plan was randomly selected for a DOL compliance audit. During the audit, the auditor noted the correction to the bonus compensation and told the plan sponsor they had not only done the right thing, but avoided potential fines and penalties well into the six figures.

How could this have been avoided? The employer clearly initiated an administrative change that conflicted with the plan document. Since this was an audit status plan, subject to an annual outside audit review, the failure to defer bonus compensation should have been caught by the auditor, but apparently was never questioned.

Final Thoughts

Running a business involves monitoring a lot of details in a dynamic, changing environment. The same is true for monitoring your 401(k) or 403(b) plan. Operational and administrative mistakes are going to happen, but having a monitoring process in place can help keep those mistakes from becoming bigger problems. As a plan fiduciary, you can't assume that your vendors are watching out for your plan and the best interests of you or your plan participants. They are in the business of servicing the plan in their defined capacity, and the burden of making sure compliance items are addressed and administrative mistakes are found and corrected are your responsibility.

As an employer sponsoring a qualified, defined contribution retirement plan, you have three primary fiduciary roles; plan sponsor, plan trustee and plan administrator. You have many options available today to outsource the fiduciary oversight and compliance burden for both the investment fiduciary functions and the operational fiduciary functions. On the investment side, your advisor may already be serving as a fiduciary to your plan, or may have engaged an investment fiduciary for your plan. There are two types of investment fiduciaries; ERISA 3(21) or ERISA 3(38), which reference the code sections under ERISA for their fiduciary role. In general, these fiduciaries assume responsibility for the selection of the investment options provided in the plan and the responsibility for monitoring those options in accordance with the plan's investment policy statement.

On the operational side, the outsourcing options vary widely. 401k Safe is a fiduciary service which allows the employer to outsource the roles of plan trustee and plan administrator. The employer remains the sponsor of their plan, but now has a firm that monitors the compliance and administration of the plan to ensure that the plan is compliant if audited by the DOL or IRS. If this is a service you would like to investigate for your plan, contact your plan's advisor to discuss how this solution could benefit your plan.

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