Overlooked responsibilities

Areas of risk in 401(k) plans that expose companies to audits, litigation

INTERVIEWED BY ADAM BURROUGHS

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Many employers offer a 401(k) retirement plan to their employees. In doing so, employers are generally aware of some of the key fiduciary responsibilities imposed upon them under federal law. However, there are other aspects of the operation and administration of 401(k) plans that can be overlooked. In doing so, employers become vulnerable to litigation and/or governmental audits.

Smart Business spoke with Patrick J. Egan, a partner in the Corporate & Securities and Labor & Employment Practices at Brouse McDowell, about the aspects of plan management companies tend to miss and the risks that creates.

What are the fiduciary duties employers tend to overlook?

In many circumstances, an employer will establish a 401(k) plan for its employees and will fail to ensure that its operation and administration satisfy the requirements imposed under the Employee Retirement Income Security Act (ERISA).

Under the provisions of ERISA, plan sponsors have a responsibility to make sure that the expenses and fees associated with their 401(k) plans are reasonable. If an employer has failed to review and benchmark plan fees for an extended period of time, it could constitute an ERISA fiduciary breach because third-party vendors are generally paid directly from the assets of the 401(k) plan. Thus, the higher the fees, the lower the account balances of the 401(k) participants. Employers should be reviewing and benchmarking the fees assessed by the plan's service providers by issuing Requests for Proposal (RFPs) about every three years.

Employers also cannot ignore the overall performance of the investment funds offered under their 401(k) plan. If, for example, a large-cap mutual fund has underperformed over the past few years, the employer has a fiduciary duty to analyze it and determine whether it should be removed and replaced by a better-performing fund option.

Why are these aspects of 401(k) plan management under scrutiny?

A series of lawsuits filed by attorneys representing 401(k) participants has brought the issues regarding plan expenses and investment performance into the spotlight. Moreover, these issues have also become a point of emphasis for the U.S. Department of Labor (DOL) when it conducted plan audits. Therefore, employers now need to be more proactive regarding the operation of their plan to mitigate the possibility of any litigation or a DOL audit.

What steps can employers undertake to satisfy their fiduciary obligations?

Employers need significant processes and procedures in place that fully address the operations of their 401(k) plan. For example, employers should consider delegating responsibility to an investment committee that meets periodically to oversee the operations of their 401(k) plan, review the fees assessed by third-party service providers, review the performance of the plan's investment options and replace underperforming investment options. Further, each investment committee meeting should be documented and the written minutes reviewed and approved at the next meeting.

There is an overall duty under ERISA that fiduciaries must act prudently. The DOL has noted that prudence focuses on the process for making fiduciary decisions. Therefore, having a committee meet periodically to review the 401(k) plan can satisfy these fiduciary responsibilities.

What should companies do to correct any potential fiduciary oversight issues?

Employers should review the current structure and operation of their 401(k) plan. Reaching out to legal counsel may be prudent, as they can conduct a comprehensive review of the process and procedures currently in place and determine whether they are sufficient for purposes of ERISA. Further, legal counsel can assist the employer or investment committee in navigating the RFP process and can also conduct fiduciary training so that the investment committee members fully understand their fiduciary obligations as imposed under ERISA.

Employers need to be aware of the changing regulatory and legal environment and become more involved with their 401(k) plan in order to address increased litigation and governmental oversight. ●

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