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What Physicians Need to Know about the New 401(k)

Steven Abernathy and Brian Luster | Monday, January 27, 2014

There is newly updated information about 401(k) compliance that's of the utmost concern to medical practices — particularly small businesses (defined by The Department of Labor (DOL) as an organization of 100 employees or less).

If your medical practice's 401(k) plan hasn't been audited by the government yet, you may not have to wait long — the DOL brought on nearly 1,000 new hires whose role is to enforce ERISA rules by serving as watchdogs and issuing government fines (or worse) to offending employers.

An estimated 88 individuals, including plan officials, corporate officers, and service providers, were criminally indicted for offenses related to their benefit plans, according to the DOL. Who assumes fiduciary responsibility when the government's rules are not met? You do. If these rules go unmet, substantial fines can add up. Last year, the average fine was $600,000 per plan — an increase of almost $150,000 in the past four years alone. Doctors need to be aware of the consequences and know what to do to benchmark their current 401(k) plans.

No one puts a benefits package together with the intention of getting fined or unduly burdening plan participants. However, last year nearly 75% of plans audited by the DOL were either fined, received penalties or had to make reimbursements for errors. If a plan doesn't pass the DOL's new standards, in addition to steep fines, criminal indictment is possible, however unlikely.

No physician intends to invite a public relations nightmare to their door, but any doctor with participants enrolled in the company retirement plan is legally responsible to assure the plan follows the DOL's guidelines. A thorough review of your 401(k) plan serves to reduce chances of unnecessary litigation, keep unscrupulous financial services firms out of participants' pocketbooks, and be up-to-date with new regulations.

It is advisable for plan sponsors; particularly those with small plans, to have their current 401(k) professionally benchmarked to reveal any hidden fees, expenses, and liabilities within it, as small plans may carry fees as high as 3% per year. According to Demos.org, over a participant's lifetime, these fees can rob investors of nearly 35% of their total returns. Should financial advisors, who put up no capital and take no risks, take over a third of participants' returns when they put up all of the capital and take on all of the risk?

We think not. If your company's 401(k) plan hasn't been audited to date, one of the new government hires may do just that — and you want to be adequately prepared.

401(k) fees

401(k)s were first created in the late 1970s as the U.S. government tried to limit the amount of cash-deferred compensation plans being offered. An enterprising business consultant to Johnson & Johnson discovered a loophole that allowed highly compensated executives and their participants to save more of their pre-tax dollars for retirement — and the 401(k) was born.

Today's plans can be relatively complex, but the original plans were straightforward and offered only

two investment options: a guaranteed fund and a single equity mutual fund. As executives wanted to add more flavors to the menu, these options got more complicated; two options became 15, which in turn became thousands.

As the menu of investment options grew, an opportunity for middlemen to get involved at the expense of the American worker through layer upon layer of fees presented itself. Institutions offering small plans (largely brokerage firms and insurance companies) knew that plan sponsors would be unlikely to realize their plan participants were bearing unnecessary expenses or that enterprising salesmen had created revenue streams in excess of their annual advisory fee by selecting investment options laden with upfront sales charges, mark-ups and recurring fees.

Fast-forward to last year when EBSA released a final rule for increased transparency about fees in 401(k) plans. While the news didn't receive much fanfare, ERISA mandates state that fees paid both at the participant level and the plan level be "usual and customary" for what the market dictates. If your plan was compliant five years ago, it's not necessarily compliant today; in fact there is a high likelihood it isn't.

According to a recent piece in Fortune, excessive fees accumulated over 30 years can erode as much as 37% of returns. Demos, a New York-based think tank, concluded that an ordinary American household will spend nearly $155,000 in 401(K) fees over their lifetime. Plan sponsors are on notice — participants are going to notice if they're paying excessive (and illegal) fees. It's imperative to be sure your practice is compliant with the new rules, which took effect last August. The easiest way to do that is to hire a professional to benchmark your 401(k) plan.

Here are other recommendations:

Hire a co-fiduciary. A plan sponsor has a fiduciary duty to act in the best interest of plan participants. If you are not a prudent expert, find that expertise in a co-fiduciary. It's not only good business for that advisor to be a fiduciary, it is imperative. The firm chosen to put your plan together must share in your risk — not profit from it. So rather than working with a broker, who may be compensated by steering the plan sponsor toward funds that increase the sponsor's risks and pay the broker a higher commission, we strongly suggest your investment advisor serve as a fiduciary, choosing the investment choices that are best for both plan participant and plan sponsor.

Build a 404(c) compliant line-up which provides a variety of investment options 404(c) compliance allows you, the plan sponsor, to shift responsibility for investment results to plan participants. Provided your plan allows participants to choose from a menu of varied investment choices, it's vital that your menu is 404(c) compliant. Essentially, what this does is relieve your plan fiduciary of the liability arising from your participants individual investment decisions.

Consider a fund line-up that consists of a broad group of low-cost, passively managed index funds, with little overlap, that give participants access to multiple asset classes. Provide participants with education and support. Any retirement plan provider should provide the plan sponsor with comprehensive enrollment materials, educational content, a website with interactive tools, and access to an investment advisor that participants can access for one-on-one support in order to make better financial decisions. Educated participants are less likely to make uninformed decisions, and, not offering educational information sessions could put employers at risk. The investment advisor should also conduct a risk tolerance review with each plan participant.

Adopt a formal, written investment policy ERISA Section 402(b)(1) requires retirement plans to provide a "procedure for establishing and carting out a funding policy and method consistent with the objectives of the plan." A formal investment policy identifies: a) the investment goals and objectives of the plan; b) sets the decision-making process for structuring the overall make-up of the portfolio

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and selecting investments; and c) specifies the measuring tools for ongoing performance assessment. The investment policy should focus on how investment decisions are made, rather than the investments themselves. Adhering to ERISA Section 404(c) guidelines with a formal, written investment policy provides plan sponsors added protection.

Be wary of the “no cost” plan Many group annuity insurance firms understand businesses don’t want to pay anything when beginning a 401(k) for participants, so, they offer to charge a wrap fee as an alternative. It essentially marks up the cost of the underlying investments by as much as 1% to 1.5% per year. The firms that do this know this fee isn’t enough to cover their administrative and recordkeeping expenses for your plan upfront. However, after five years, when there’s a $2 million to $3 million payroll, they know it’s unlikely their rates will be renegotiated. So plan sponsors continue paying excess fees, which line the pockets of plan administrators and their brokers. Reuters recently wrote about one such lawsuit involving Mass Mutual. The best way to avoid such headaches is to know what you are getting into from the get go; professional benchmarking is valuable here.

Consider adding options to allow contributors to increase annual tax deductible retirement contributions beyond the statutory $17,500 annual pre-tax contribution limits A Profit Sharing Plan will enable higher income earners to save as much as $50,000 per year for retirement through tax deferred contributions, and a Defined Benefit Plan, in addition, may enable some participants to save $200,000 per year in pre-tax contributions. At 5% in annual appreciation, a plan participant would have accumulated over $2 million in additional tax deferred savings, assuming only $50,000 in annual pre-tax contributions.

Compliance. Just because your plan was compliant five years ago, doesn’t mean it is compliant today. Wise plan sponsors will have an independent third-party benchmark their plan at least once every year. Today’s new rules, as well as the DOL’s attention on small businesses, could mean more employers in the hot seat. Be clear as to what burdens in your 401(k) plan lie on you — and what do not.

Steven Abernathy and Brian Luster co-founded The Abernathy Group II Family Office and the country's first Physician Family Office. The Abernathy Group Family Office sells no products, receives no commissions, and is independent, employee-owned, and governed by its Advisory Board comprised entirely of thought-leading professionals. Find them online http://www.abernathygroupfamilyoffice.com. Have questions you want answered? Email sabernathy@abbygroup.com or bluster@abbygroup.com.

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