Legal Risks in Your Practice's 401(k) Plan

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Introduction

Attention physicians: Do you have a 401(k) plan for yourself and your staff? There are some recent changes from the Department of Labor that you need to be aware of, especially if your plan has not been audited in the past 5 years.

As of July 1, 2012, changes in the Employee Retirement Income Security Act (ERISA) regulations governing such plans hold you, the employer -- also called the plan sponsor -- accountable for complying with new regulations. If you fail to do so, your employees may be eligible for damages. That could mean money out of your pocket. If you are a physician working for another physician, you may want to tell your boss and the office manager that these rules went into effect this summer.

Remember the old adage "no good deed goes unpunished"? Although offering employees a 401(k) certainly qualifies as a good deed and is useful in attracting top talent, not following the regulations to the letter means that you might run afoul of legal consequences. Here are the questions to ask now to determine next steps:

What do I need to review immediately?

The first order of business for any physician who has a 401(k) plan for employees is to pay attention to 2 things: (1) What are the requirements of the plan participants? Are you, as an employer, in compliance? (2) What are the expectations of the plan sponsor (that's you) independent of the retirement service plan provider? If you cannot answer these 2 questions easily, you are not alone. But you will want to have a specialist conduct a thorough audit of your plan to ensure that you are in compliance.

Where can I learn more about these changes?

The recent changes in the ERISA regulations are found in section 408(b)(2) and can be found on the Department of Labor Website. As an employer, you are required to disclose all fees to employees and to make sure that available plans are constructed to offer participants flexible choices. This means offering a range of diversified, low-cost investment options.

Am I responsible for educating my employees about their investments?

All members of your staff who want more education should be able to access it, and the more frequently the better, because this is in line with your fiduciary responsibility. It is recommended that in addition to conducting in-person, company-wide workshops with the investment advisor, employees should be able to access an objective party to assist with their investment goals several times throughout the year.

Should there be an annual formal education meeting?

Yes. The goals are to provide general education about investment options and to assist your employee plan participants in choosing appropriate investments to match their goals with as little risk as possible. At this meeting, participants will learn more about making investment choices, such as the benefits of active vs passive management, rebalancing, and dynamic asset allocation strategies over the course of a lifetime.

For employees who don't take part in these educational offerings, only the lowest-risk option should be made available to them -- an action which protects both employer and employee.

How do I assess the plan's structure to know whether it's working optimally and within the bounds of the new regulations?

This will be a challenge. As a physician, you probably have a cursory knowledge of investment plans but may not be up to date on the latest findings and investment options. The new regulations demand transparency in the operational costs of the investment advisor's product offerings, so there should be no extraneous or hidden fees. You should be able to operate the 401(k) itself at a very low cost. If needed, you as an employer may be able to pass on the costs to each employee. It may be useful to have a formal consultation to review your plan.

What is the maximum annual amount that can be saved in a 401(k) retirement savings plan?

$200,000 is the absolute maximum that combines the 3 kinds of savings allowed: (1) annual contributions; (2) profit sharing; (3) defined benefit plans. (Although defined benefit plans are becoming a rarity today, for any physician close to retirement age, in a large practice, or involved in a corporate setting, this may be applicable.)

For everyone, the more money saved, the lower your taxable income may be. If you're under 50 years old, you are able to make an elective base contribution of up to $17,000 annually. If you participate in profit sharing, combined with the elective 401(k) plan contribution, up to $50,000 can be saved. (Note: This is an unlikely scenario for most people under 50, as most profit sharing at this level is typically reserved for people at the top salary level and/or top executive level.)

The third tier of the retirement pyramid is the defined benefit plan in which participants can shelter up to $200,000 annually. This is going to be more common for participants over 50 years old because they are closer to retirement age.

Catching Up With Retirement Savings

What should someone do who is only starting to save for retirement but who is near the end of his or her career? Is there a way to "play catch up"?

Yes. A physician or staff member aged 50 or over has the option to save more money for retirement while lowering taxable income. Instead of an elective contribution of $17,000 per year, those 50 or over can contribute a maximum of $22,500 to their plans, an additional $5500.

On the profit-sharing front it's the same amount: An additional $5500 is allowed as a "catch up" allowance. So, regardless of age, even for those who start late, maximizing contributions could allow participants to amass in the low millions in 5-10 years given proper management.

The third tier of the retirement pyramid is the defined benefit plan in which participants can shelter up to $200,000 annually. Again, this is more common for participants over 50 because they're closer to retirement age -- but it's not common for new businesses and medical practices today.

Throughout this process, it is wise to consult an investment advisor to offer unbiased personalized support to plan participants and for plan development.

What is my responsibility as a physician-owner?

If you are a physician-owner and you have not provided comprehensive fee disclosures to the participants in your plan, it is very likely that you may be vulnerable to lawsuits, because it only takes 1 employee to blow the whistle on a company that is not following ERISA's new regulations. As a plan sponsor, your primary responsibility is to act as a fiduciary[1] on behalf of your plan's participants, disclose all fees, provide 100% transparency, and follow the law!

What do participants need to know?

By the end of August 2012, according to the Department of Labor, service providers must have disclosed earnings (ie, fees) that exceed more than $1000. Every participant has the right to see an accurate breakdown of costs and fees. What constitutes a "reasonable" fee? Anything for which participants derive sufficient value from the product or service they are buying is considered reasonable.[2]

How do I fulfill my role as a physician-owner in following the new rules?

As an employer, you are expected to compare and contrast the offerings and services available from a range of providers and assess not only the quality and variety of the funds, but also the level of service provided to employees based on the fees collected by the 401(k) provider. As a business owner, ask yourself: *Am I qualified to do this?* The actual total costs under the law must be clear and transparent so as to guide your decision without deceptive, hidden, or unknown fees.

How do I find the best option for myself and my employees?

There is a wide variety of low-cost exchange-traded funds (ETFs) and individual securities available; there is no reason to be confined to high-cost mutual funds today. Your investment advisor can help with information and education to fulfill the fiduciary obligation.

As an employer, what do I need to ask?

First, determine whether the best options available to you are actually on your investment menu. Underperformance ads up over the life of a retirement account. Intelligent investors must have access to passively managed funds (such as index funds) in the practice's retirement plan. Access to lower-cost, passively managed mutual funds and ETFs, as well as a self-directed plan option (which allows employees to choose their own investments), can allow more flexibility to participants who wish to invest in stocks as well as funds.

Consider having a forensic audit of your current retirement plan to ensure that the appropriate structures are in place. And if you have any questions, check with an investment professional.

References

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