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Why your practice's 401(k) may be audited

Brian Luster and Steven Abernathy
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2014 FINANCIAL PLAYBOOK

Today's 401(k) plans can be highly complex. Unfortunately, middlemen have been profiting from multiple layers of fees at the expense of the employee—unbeknownst to many employers who had the best of intentions. Legislation passed in the last two years aims to expose these hidden fees, expenses, and liabilities inside of your company's plan.

So what does this mean for physicians? Despite the new government rulings, some practices are not yet compliant. Medical practices often have small plans, defined as those with fewer than 100 participants. These plans are vulnerable to a future audit or lawsuit from an employee claiming he or she was not properly informed about plan options.

If your practice's 401(k) plan hasn't been audited yet, you may not have to wait very long. The U.S. Department of Labor hired 1,000 new employees to enforce Employee Retirement Income Security Act (ERISA) rules, and fine employers whose plans are not compliant.

Only one in four of the retirement plans audited over the last few years have received the federal government's seal of approval.

Federal legislation requires plan participants to receive full fee disclosures including: investment management, record keeping, administration, and other services. What happens if employees find out they have overpaid? Lawsuits could follow, especially among smaller plans, where the median expense ratio is three times that of larger plans.

Find a 'high quality' plan

We advise plan employers to find and sponsor plans with high quality, low cost 404(c)-compliant funds for themselves and their employees. The 404(c) structure is critical because it shifts the responsibility for investment results to a plan's participants who, after an information session about the offerings, may choose from a menu of different investment choices. This relieves your medical practice of any liability arising from your plan's participants making individual investment decisions.

We recommend a fund lineup consisting of a broad range of low-cost, passively managed index

funds that provides employees access to multiple asset classes. (Actively managed funds may be appropriate for employees or practice owners with higher incomes.)

Also consider a Qualified Default Investment Alternative for your participants. A 321 co-fiduciary (full disclosure: our family office is a co-fiduciary) can help select the right target date funds, balanced funds or model portfolios to achieve this.

Aim for a compliant group of high quality, low cost investment alternatives serving the needs of your employees at all income levels. The last thing any plan sponsor wants is to find out that an employee lost $250,000 in the stock market, and is suing for losses because something as simple as a 404(c) compliant fund line-up wasn't provided.

ERISA also mandates that the fees paid both at the participant level and the plan level are "usual and customary" for what the market dictates they should be. So while a plan may have been compliant, say, five years ago, it's likely this is no longer the case. We recommend benchmarking a fund line-up at least once every other year to ensure a plan's compliance is current.

Be cautious if offered a no-cost plan. Instead of a start-up fee, no cost plans offer to charge a "wrap" fee in which the cost of the underlying investments is marked up by as much as 1% to 1.5% per year for the same funds available elsewhere without any mark up.

Brokers who sell no-cost plans are well aware that their early "wrap" fee may not be enough to cover their administrative and record keeping expenses for your plan at the start. It's unlikely that a medical practice with a payroll of $2 million to $3 million payroll will call to renegotiate rates after a few years. What occurs is companies outgrow their britches and continue paying excess fees.

We recommend third-party benchmarking to check for usual and customary fees that are in compliance with the ERISA regulations.

Next: The problem with 401(k) plans

THE PROBLEMS WITH 401(K) PLANS

88

The estimated number of individuals including plan officials, corporate officers, and service providers were criminally indicted for offenses related to their employee benefit plans, according to the U.S. Department of Labor's Employee Benefits Security Administration fact

UNJUSTIFIED 401(K) FEES

can reduce 25% to 37% of an employee's savings, and, a standard U.S. household could spend nearly $155,000 in 401(k) fees over their working lifetime, according to *Fortune* Magazine.

73%

OF RETIREMENT PLANS

audited by the Department of Labor were fined, penalized, or had to make reimbursements for errors, the average of which was $600,000 per plan—an increase of nearly $150,000 per incident.

71%

OF RESPONDENTS

in an AARP study were unaware of any maintenance fees paid to their 401(k) provider.

3%

Plans may carry fees as high as 3% per year, depriving participants

Next: The plan sponsor's obligations

The plan sponsor's obligations

A plan sponsor's obligation is to act in the best interest of participants—as an expert. Physicians' expertise is in medicine, not retirement planning. It is extremely unlikely that any plan sponsor lacking this expertise will acquire it. Therefore, we advise plan sponsors to bring on co-fiduciaries with that expertise. It's not merely intelligent; it's imperative.

A firm devising your employee retirement plan must share any risk, not profit from it. Instead of working with a broker, who may be tempted to increase his or her compensation by steering a plan towards funds that increase risks (yet pay the broker a higher commission), we suggest choosing an investment adviser who will serve as a fiduciary, choosing a menu of intelligent investment choices for both you and your plan participants.

It's also wise to add options allowing employees to increase their tax deductible retirement contributions beyond the statutory $17,500 annual pre-tax contribution limits. There are a few ways to do this. One is through a profit sharing plan. This would enable the higher income earners to save as much as $50,000 each year towards retirement through tax-deferred contributions.

Add a defined benefit plan on top of that, and it may enable participants to save more than $200,000 per year in pre-tax contributions. At a mere 5% in annual appreciation, over 23 years, your doctors will have accumulated more than $2 million in additional tax-deferred savings, assuming $50,000 in annual pre-tax contributions. For some types of specialist practices, or who simply have high earning physicians, this will become immediately valuable for your doctors.

Employee education is vital

Plan participant education and support is also necessary for ERISA compliance. We strongly suggest holding educational sessions regularly throughout the year. Your retirement plan provider should provide comprehensive enrollment materials, educational content for plan participants, a website with interactive tools, and access to an investment adviser for one-on-one support to help employees make financial decisions that are right for their needs.

Failing to provide employees with education puts a plan sponsor at serious risk if an employee makes bad investment decisions inside their 401(k) account. Advisers are urged to conduct a risk tolerance review with each plan participant. This can help to reduce any liability that might arise from an employee's investment decisions.

If your medical practice's plan has not been audited within the past two years, it's time to schedule one to determine if a restructuring is required. Given that 75% of plans audited over the last few years have failed the government-set standards, yours may not only be too expensive, but present a looming liability.

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