



Tales of 401(k) Administration Gone Awry – Part 2

In Part 2 of our series on 401(k) administration errors, I will discuss some other problems we commonly see when working with clients – particularly new clients – and how we address them.

“You won’t have to do anything at the end of the year.” In this case, the vendor’s salesperson had told the client, “We’ll set up your payroll feed to contribute a full pay file every payday, so we’ll have the information already and the end-of-year census” – which this client hated having to deal with – “goes away.” This is of course not true; there are all sorts of reasons why the client has to actually verify the end-of-year census – and why it won’t match what they sent in during the year. As a result, the client had to go back and redo their contribution tracking, make corrections, and ultimately pay a penalty.

Bonuses. Some clients give employees a monetary bonus at the end of the year, and they don’t want to see deductions taken from those bonuses. There are a couple of potential problems here: What does the plan document actually say? Does it specify that employees are allowed to make deferrals based on their bonuses? Is there a form for them to make that choice official? If there’s no deferral contribution, typically the client isn’t uploading that payroll – reasoning, “If there are no 401(k) contributions, I don’t need to submit the payroll.” The result is an entire payroll with compensation that counts in the definition included in the W2 comp guidelines, is missed. The absence of that information can cause a number of problems.

Participation compensation. Oftentimes an employer will not want to count the period of time when a new employee was not yet contributing to the plan. That seems sensible; the problem is when you download your end-of-year census, the system doesn’t know any better than to give that employee’s *full-year compensation*, not just their compensation while participating. There is no automated way to handle this; you have to go back, person by person, and manually extract the data to determine participation comp for affected participants.

“We don’t do it that way.” We have seen situations where the plan document says one thing but the client says otherwise. We always have a plan document call whenever we bring on a new client to discuss in detail what the document says – and whether that’s what is actually being done. With one client, somewhere along the line bonuses for salespeople had been excluded; that got changed to where they were included, but the client continued to do it the old way. Ultimately the client had to write some checks, and was unhappy about it. In another situation, the plan document called for a payroll match but the client’s policy was not to match on the final payroll after a participant quit the company. That may be a normal thought to have, but it was not permissible under the plan document.

A bloody mess. I’ve had a number of client plans you could classify as “a bloody mess.” (Many of these tend to happen when you first pick up a client, not after you’ve been working together for a while.) Examples include: salesperson commissions were not reported when they should have been; distributions were made incorrectly; auto-enroll was instituted but no one was auto-enrolled (another of the “I thought you did that” instances). The last cost the employer some \$500,000 in penalties.

Failure to start matching. The concept of “dual eligibility” can be an important factor here. This is not something we necessarily recommend, but some employers allow an employee to

immediately start making salary deferrals into the plan, with matching funds kicking in one year later. But the system only handles the first eligibility; the second, regarding matching funds, must be made manually by the employer. Should that task go unattended, the employer ultimately will have to make up back contributions plus interest.

Shouldn't have sent the check. In one case, a former employee at a doctors' group had gotten divorced and received a domestic relations order (DRO), which splits a retirement or pension plan account by recognizing joint marital ownership interests in the plan -- specifically the former spouse's interest in that spouse's share of the asset. But in this instance the DRO wasn't properly completed, and the ex-spouse received authorized distributions that she wasn't really supposed to get. The doctor in charge ended up writing a personal check for tens of thousands of dollars to the former employee when the ex-spouse refused to return the money.

In another case, an employee who had been divorced and re-married had named the children from his first marriage as beneficiaries. There is a rule that a spouse must submit their notarized consent if anyone other than the spouse is named as a beneficiary; that did not happen in this situation. As a result, the company's fiduciary made distributions to the children once the employee died -- without the second wife's consent -- resulting in that wife suing the company.

So what can be done to address not only these problems -- most of which a third-party administrator can address -- but those which will remain one of your chores? Designing a plan smartly -- and sticking with it -- is of course the top priority. Doing so in a way that avoids doing manual work (as with the dual eligibility example) and difficult payroll situations will solve a lot of problems.

Next, hire a professional, independent fiduciary administrator. Let someone else fly the plane.

Thirdly, you still need a willing client. We would love to get our clients out of the middle of the administrative burden. We feel we can get them pretty far away from the middle -- but there will always be some chores that they have to do.

About the Author

As Senior Vice President, National Sales, Pete Swisher oversees Pentegra's sales and business development efforts. He brings more than 15 years of industry expertise to Pentegra, with a background that not only includes in-depth knowledge of retirement plan operations and business models but also vast expertise working with financial advisors to build successful retirement practices. Pete is the author of 401(k) Fiduciary Governance: An Advisor's Guide, a textbook for the ASPPA Qualified Plan Financial Consultant credential. He may be reached at pete.swisher@pentegra.com .