Guest Column

Financial Crisis Highlights 401(k) Plan Exposure

By Joseph S. Musher

Major investment houses and banks have failed. A credit facility crisis is upon us. The Dow Jones Industrial Average plunges 777 points in a single day. The market value declines $1.2 trillion in a single day. Who would have thought as recently as a month ago that these events would become true? But they have!

With the decline of the traditional defined benefit plan, the defined contribution plan (of which the 401(k) plan is the most popular) has taken a significant role in providing the retirement benefits of millions of participants. It may represent trillions of dollars. The Department of Labor's Employee Benefits Security Administration (EBSA) proclaims in its mission statement that it protects the integrity of these employee benefit plans and its mission is to "deter and correct violations of the relevant statutes through strong administrative, civil and criminal enforcement efforts to ensure workers receive promised benefits."

These plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). Regardless of the party administration, EBSA takes a vigilant role in protecting these benefits. A significant amount of their resources are devoted to Department of Labor auditors. Remember, the Department of Labor theoretically has unlimited resources and time to expend on the audit of your plan.

In LaRue v. DeWolff, Boberg & Associates issued on February 20, 2008, the Supreme Court concluded that an individual participant can recover losses under ERISA. James LaRue alleged that the 401(k) administration breached its fiduciary duties by failing to follow his investment directions, thereby costing him approximately $150,000.

What does this mean to the plan trustees and administrators? Literally, greater financial exposure for not doing the right thing. Two large areas of concern are paperless transactions and timely contributions.

With the growth of the 401(k) plans and technology, many service providers provide many options the participant may implement directly on the web. From the participant's point of view, this is great. From the plan administration viewpoint, a new array of issues occur.

First, and foremost, is the internal control structure the service provider must have over the system. If a transaction is not properly implemented, the LaRue decision allows the participant to seek remedy from the fiduciary. This recovery remedy is not a plan expense but a personal expenditure of the fiduciary. What action should the plan administration or trustee consider? First, make sure the plan carries fiduciary liability insurance to indemnify the administrator or trustee from innocent errors. Second, have legal counsel examine all service provider contracts to verify that the plan and/or trustee is adequately covered in the event of errors by the service provider. Third, I propose that the plan administrator/trustee take a proactive approach with their service providers.

Most service providers should have a SAS 70 (Statement of Auditing Standards No. 70) report on their internal control structure prepared by an outside expert. This report is extremely valuable to you. It describes the testing and evaluation of the internal control structure by independent experts. I strongly recommend that the plan administrator, on behalf of the trustee, obtain a copy of this report, if available. The report should be analyzed, and if need be, test the system yourself. If the system is not operating properly, the LaRue decision makes the consequences potentially drastic. Finally, the plan should consider an internal audit of itself. Confirmation to participants regarding contributions, investment selection and investment would be appropriate.

The law requires that employee withholding contributions to their 401(k) plan be deposited to the plan as soon as the amounts can be segregated from the general assets of the employer, but in no event more than 15 days after the end of the month in which amounts are contributed or withheld from wages. It is extremely important to note that the deposit should be made at the earliest date. The DOL has been contemplating a change of this rule (I think because of the general term of segregation from the general assets as soon as practicable is unclear and vague), but the latest is this will not change for large plans (generally plans with participants over 100 employees).

Since the employee withholding of their 401(k) contribution is considered a plan asset, a delay in the timeliness of the deposit will result in a prohibited transaction, Federal excise taxes and lost earnings on the delay. With the volatile markets of today, a one-day delay could have a dramatic impact; if not financial, certainly in confidence of management. With the credit market extremely tight, employers should not even consider this an avenue for short-term internal financing. The results could be disturbing.

In the event that the plan makes an error, the Voluntary Fiduciary Correction Program (VFCP) provides relief for 19 categories of transactions. (See www.dol.gov/ebsa/newsroom/fs2006vfcp.html.) Unlike some government agencies, I have found the staff of the regional offices and national headquarters of EBSA quite helpful.

In times of economic difficulty such as today, participants may be more eager to borrow from their 401(k) plans. Trustees need to verify that the proper amount is borrowed (there are limitations) and that proper documentation is prepared, authorized and approved. The plan needs to monitor these loans. Delinquent loans are required to be reported on Form 5500 to be filed with the DOL.

Now, more than ever before, you should make sure your plan is operating in accordance with the DOL regulations and you are responsive to participant inquiries.

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