Helping Employees Prepare for Retirement While Protecting Your Company

7 Critical Questions To Ask to Ensure an Effective and Compliant 401K Plan

A 2014 study reported that more than six in 10 U.S. households are relying on an employer-sponsored retirement plan -- defined benefit, defined contribution or both -- to help them save for the future. If your company is offering such a plan – or considering adding one to help attract and retain valuable employees – you've made an important commitment to helping them achieve a more financially secure retirement.

With so many individuals depending upon these retirement vehicles for their futures, it’s no wonder there are strict laws in place to protect investors – in this case, your employees and their beneficiaries. Management of the plan must be performed up to the heightened fiduciary standards established by the Employee Retirement Income Securities Act of 1974 ( “ERISA”).

To help you better understand your role and responsibilities as a retirement plan sponsor, I’ve assembled the top seven questions I am regularly asked by business owners and HR executives who seek professional advice when setting up retirement plans that are attractive to their employees, yet ensure full ERISA compliancy for their organization.

1. **What is ERISA’s definition of a Plan Sponsor Fiduciary and what are my responsibilities?**

ERISA generally defines a fiduciary as anyone who exercises discretion, control or authority over plan investments or administration. Fiduciaries may include the business owner or plan sponsor, the plan administrator, the trustee of the plan, and/or a specially-designated Investment Committee.

As a plan sponsor fiduciary, ERISA holds you accountable for the initial selection of investment options made available to your participants and for monitoring the performance of those investments. Among other responsibilities, ERISA requires you to:

- Act solely in the interest of plan participants and their beneficiaries
- Act with care, skill, prudence and diligence
- Diversify the plan’s assets to minimize the risk of large losses
- Act in accordance with the documents and instruments governing the plan

All plan fiduciaries must understand they may be held personally liable for a breach of their responsibilities. If you do not have the expertise to carry out any of the required functions, it is the fiduciary’s responsibility to hire plan service providers who have the specialized knowledge and experience to manage the plan.

As a best practice, I recommend creating a fiduciary audit file to help you organize your plan documents and records, as well as demonstrate that policies and procedures were established. Ask your financial advisor for a Fiduciary Audit File Checklist to help you get started.

2. **Are we providing the right level of education to our participants per the ERISA guidelines?**

Employee communication is an integral component of fiduciary responsibility. Employees need to understand how the plan works, as well important information about the plan’s investment options. Your financial advisor can help you set up a strong education program for your employees.

In addition to printed materials and a plan website, consider having your financial advisor deliver onsite presentations to educate your employees. You may also want to consider giving employees the option to sign up for one-on-one meetings with your financial advisor so that they may ask questions about their specific situation. In some cases, participants are too shy to ask questions in a general meeting.
Education materials should include:

- The benefits of plan participation and increasing plan contributions
- The impact of pre-retirement withdrawals on retirement income
- The terms for the operation of the plan
- Details about each investment option, including objective, risk and return characteristics and historical performance
- General investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return and the benefits of tax-deferral
- Historical rates of return among assets classes based on standard market indices
- The effects of inflation
- How to estimate future retirement income needs, determine appropriate investment time horizons and assess personal risk tolerance levels

The Department of Labor (“DOL”) has issued guidelines on specific documents that must be furnished to participants and their beneficiaries. These include:

- Summary Plan Description
- Summary of Material Modification
- An individual benefit statement (self-directed individual plans must provide quarterly statements)
- Summary Annual report
- Any applicable blackout period notice
- Certain other plan-related documents must be available upon request.

3. What is an ERISA bond?

Also known as a Fidelity bond, an ERISA bond is necessary in a 401K plan. ERISA Section 412 generally requires every person who handles plan funds or other property to be bonded to protect the plan against loss due to fraud or dishonesty. The amount of the bond must be at least 10% of the amount of the funds handled, but no less than $1,000. An ERISA bond is not required to exceed $500,000 ($1 million for plans that hold employer securities).

As a plan fiduciary, you may also want to consider purchasing fiduciary liability or pension trust liability insurance for additional protection.

4. What is a Qualified Default Investment Alternative (QDIA) and how can it help protect our company?

If a participant signs up for your retirement savings plan, but does not make an investment election, a Qualified Default Investment Alternative can protect you from fiduciary liability.

To qualify for this fiduciary protection, you must follow these QDIA rules:

- Participants must have had an opportunity to select investments but have not done so
- A notice relating to the QDIA must be given to participants in advance of the initial investment and annually thereafter
- Participants must receive certain investment information on the QDIA, such as prospectuses
- Assets of the participant’s account must be defaulted into the QDIA
- Participants must be able to direct investments out of the QDIA as frequently as other plan investments, but at least quarterly
- Fees for the QDIA should not be greater than those charged to participants using that investment option
- The plan must offer a “broad range of investment alternatives” as defined in the regulations under section 404(c) of ERISA
5. **What is the best way to ensure the investments within our plan are being monitored properly?**

According to ERISA, retirement plan fiduciaries must carry out their duties prudently and act in the best interest of plan participants. Many plan sponsors find their fiduciary responsibilities to select and monitor an appropriate menu of investments to be the most challenging. Work with your financial advisor to set up a process to monitor investments. Also while not an ERISA requirement, you may ask about setting up an investment committee and an investment policy statement.

A process for selecting investments should include consideration of a variety of statistical and non-statistical factors, which include:

- Investment objectives
- Performance relative to its index and peer group
- Risk characteristics
- Investment style
- Fees (including expense ratios and other potential costs, such as redemption fees)
- Manager tenure
- Style consistency, and
- The degree of correlation with other plan investment options

Fiduciaries have a legal duty to monitor – and remove, if no longer appropriate – the investment options in their retirement plans.

6. **What is non-discrimination testing and how does it impact a 401K plan?**

The Internal Revenue Service regulations governing 401K plans implemented non-discrimination tests to ensure that 401(k) plans benefit all employees in a nondiscriminatory manner. For purposes of these tests, employees are divided into two classes: highly compensated employees versus non-highly compensated employees. The spirit of non-discrimination testing is for both the highly compensated and non-highly compensated employees to benefit from a company’s 401(K) plan.

These non-discrimination rules are known as the Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests. It is recommended that you clearly understand what these tests look for and run sample tests during the year to estimate if your company will pass the requirements at year-end.

If your company is failing or at risk of failing non-discrimination testing, please talk to your financial advisor about 1) providing additional onsite employee education to increase participation, 2) setting up auto enrollment or 3) setting up a “Safe Harbor” match.

7. **Are we required to provide a matching contribution to our employees?**

While a match is a nice benefit to offer employees, there is not legal requirement to do so. If your company is not in a position to match initially, this should not prevent you from offering a 401K plan to your employees. After all, even a 401K without a match is a meaningful benefit, as it allows employees to contribute on a pre-tax basis to a tax-deferred account that will enable them to save for retirement.
Helping You Manage Your Fiduciary Responsibilities

Many retirement plan fiduciaries are not experts in investment management, plan administration or financial education. As a result, they can and should seek out seasoned professionals to help ensure they are fulfilling their fiduciary responsibilities, while providing a meaningful benefit to their employees and beneficiaries.

I guide senior executives as they structure their company’s retirement plan to provide a robust platform for their employees, while ensuring proper oversight. I am ready to help you achieve your specific company goals by working with you and your leadership team.

About the Author

Solaria Perez-Stepanov is an International Client Advisor and Portfolio Manager at Morgan Stanley. With over 10 years of experience in the financial services industry, Solaria has dedicated her career to helping business owners and corporate executives understand and meet their fiduciary responsibilities. She provides guidance and assists executives in making the right investment decisions to maximize the benefits of their company’s 401K plan. Solaria’s approach includes a rigorous due diligence process and a commitment to providing outstanding service and advice.

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