

What to Expect During a 401(k) Plan Audit And How The TPA Experts Can Help



Top 401(k) Plan Design and Operational Mistakes and How to Avoid Them

Designing a 401(k) plan that meets both the needs of your employees and the regulatory requirements is no small feat. As a plan sponsor, you bear the responsibility of ensuring that your plan is administered correctly and that it aligns with your company's objectives. However, common mistakes in plan design can lead to costly errors and even penalties. Below, we discuss the top mistakes and how you can avoid them to ensure your 401(k) plan operates smoothly and effectively.

Not Aligning Plan Design with Company Objectives

A common pitfall is failing to align the 401(k) plan design with the company's overall objectives. Whether your goal is to retain top talent, encourage retirement savings, maximize the benefit for owners, or simply comply with regulatory requirements, your plan design should reflect these goals.

How to Avoid It: Begin by clearly defining your objectives. Are you trying to maximize employee participation? Is it important to offer a generous employer match to attract talent? Understanding your goals will help you choose the right features, such as automatic enrollment, matching contributions, cross-tested profit-sharing options, and vesting schedules. Regularly review these objectives as your company evolves and adjust your plan accordingly.

Overcomplicating the Plan Structure

Complex plan structures can lead to administrative errors, confusion among participants, and even non-compliance with IRS regulations. Overly complicated eligibility requirements, vesting schedules, or matching formulas can create headaches for both plan sponsors and participants.

How to Avoid It: Keep it simple. While it might be tempting to create a plan with a lot of bells and whistles, simplicity often results in better understanding and fewer errors. Consult with your plan administrator or a fiduciary advisor to ensure your plan's features are easy to manage and comprehend.

Neglecting to Offer a Competitive Employer Match

A competitive employer match is a key driver of employee participation in a 401(k) plan. If your match is not competitive with industry standards, it may reduce the perceived value of your plan and affect your ability to attract and retain talent.

How to Avoid It: Regularly benchmark your employer match against industry standards and competitors. If possible, consider enhancing your match to make your plan more attractive. Additionally, communicate the value of the match clearly to your employees so they understand the full benefit of participating in the plan.

Not Timely Remitting Plan Contributions

One of the most common and severe mistakes plan sponsors make is failing to remit employee contributions to the 401(k) plan in a timely manner. The Department of Labor (DOL) requires that employee contributions be deposited into the plan as soon as they can reasonably be segregated from the employer's assets, but no later than the 15th business day of the following month. However, the DOL typically expects deposits to occur much sooner, often within a few days of the payroll date. Failing to remit contributions timely can result in the DOL assessing penalties, and, in extreme cases, it could be considered a prohibited transaction, leading to further fines and corrective actions. Ensuring timely remittance is not just about compliance—it's about protecting your employees' retirement savings and maintaining their trust in the plan.

How to Avoid It: To ensure timely remittance, consider setting up a 360-degree integration with your payroll provider and plan recordkeeper, which automates the transfer of contributions as soon as payroll is processed. If your current systems do not support this level of integration, establish a strict internal process with clear deadlines for transferring contributions. Regular audits of your processes and documentation can help identify any delays before they become a compliance issue.

Using an Incorrect Definition of Compensation

The plan document specifies the definition of compensation that must be used for determining contributions, limits, and nondiscrimination testing. A common mistake occurs when the compensation used for these calculations does not align with the definition provided in the plan document. This can lead to incorrect contributions, improper testing, and potential compliance failures.

How to Avoid It: Review the plan document carefully to understand the specific definition of compensation that applies. This might include or exclude certain types of compensation such as bonuses, overtime, or commissions. Work closely with your payroll provider to ensure that the correct compensation data is used for all plan calculations. Regular audits of compensation data against the plan document can help catch any discrepancies early.

Failing to Securely Handle Participant Data and Transactions

In the digital age, cybersecurity is a critical concern for 401(k) plan administration. A common mistake that can expose sensitive participant information is the failure to use secure methods for handling transactions such as loans and distributions. For example, employees might email sensitive forms and documents directly rather than using a secure portal, putting participant data at risk of being intercepted by cybercriminals.

How to Avoid It: The best and most secure solution is to ensure that all loan and distribution requests are initiated directly through the recordkeeping platform. These platforms are designed with robust cybersecurity measures specifically for 401(k) transactions, offering layers of protection against cyber fraud. If using a recordkeeping platform is not possible, enforce strict policies requiring the use of secure portals or encrypted communication methods for any sensitive transactions. Regularly train employees on cybersecurity best practices and the importance of safeguarding participant data.

Ignoring Plan Compliance and Regulatory Changes

401(k) plans are subject to a myriad of regulations, and these rules are continually evolving. Ignoring compliance requirements or failing to keep up with regulatory changes can result in penalties, fines, and even the disqualification of your plan.

How to Avoid It: Work closely with your plan advisor and third party administrator to ensure your plan remains compliant. Regularly review your plan documents, procedures, and operations to align with current regulations. Make sure to document any changes or decisions made concerning the plan—this documentation will be invaluable if any questions arise from participants or regulators.

Not Operating the Plan According to the Plan Document

Failing to operate the plan in accordance with the plan document is a critical mistake that can lead to significant compliance issues. This includes not following eligibility rules, not applying the correct vesting schedules, or not implementing the plan's distribution provisions correctly. Any deviation from the plan document can result in the plan becoming disqualified, leading to severe tax consequences.

How to Avoid It: Ensure that everyone involved in administering the plan fully understands the provisions of the plan document. This includes HR, payroll, and any third-party administrators. Regular training and updates should be provided whenever the plan document is amended. Consider conducting internal audits or working with a 3(16) fiduciary to review plan operations and ensure they align with the plan document.

Failing to Regularly Update the Plan Document

The plan document is the legal foundation of your 401(k) plan. Failing to update it regularly to reflect changes in law, company policy, or plan design can lead to operational failures and potential compliance issues.

How to Avoid It: Work with your third party administrator to review and update the plan document at least annually or whenever significant changes occur. Ensure that all amendments are properly documented and communicated to relevant parties.

Inadequate Participant Communication and Education

Even the best-designed 401(k) plan can fail if participants don't understand it. Poor communication can lead to low participation rates, improper investment choices, and overall dissatisfaction with the plan.

How to Avoid It: Implement a robust participant education program. This can include regular workshops, online resources, and personalized advice sessions. The more informed your employees are, the more likely they are to take full advantage of the plan, resulting in better outcomes for everyone involved.

How The TPA Experts Can Help

At The TPA Experts, we understand the complexities of designing and maintaining a 401(k) plan. Our team specializes in helping plan sponsors navigate these challenges by offering customized plan design services, compliance monitoring, and participant education programs. We focus on aligning your plan with your company's goals,

simplifying administration, and ensuring your plan remains compliant with evolving regulations. While we strive to provide the highest level of service, our goal is to empower you with the tools and knowledge to avoid these common mistakes and deliver the best possible outcomes for your employees.

Conclusion

Designing and maintaining a 401(k) plan is a dynamic process that requires ongoing attention and adjustment. By avoiding these common mistakes, you can create a plan that not only meets regulatory requirements but also serves as a valuable tool for recruiting and retaining top talent. Remember, the key to a successful 401(k) plan is aligning it with your company's goals, keeping it simple, benchmarking fees, educating participants, and staying compliant with regulations.