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401(k) fright

A poorly structured plan can cost you money and employees and put you at risk.

By Ray Marano

A closely held company has an employee retirement plan with low participation, perhaps because of a poor structure and limited investment options. It's something that Bob Fragasso, president of The Fragasso Group, a financial consulting firm, sees all too often in his practice.

One of Fragasso's clients, a closely held corporation, had a 401(k) plan in which only 30 percent of the employees participated, one senior company member decided on all of the investment allocations for all employees and the plan provider was lax in providing information to participants.

Even more, as fiduciaries, the company owner and senior managers were assuming too much liability for the plan. And low participation by employees could be costing owners and senior managers by limiting their own contributions to the plan.

The scenario isn't all that unusual.

"That, frankly, is rampant," says Fragasso.

To improve this particular client's plan, The Fragasso Group advised the following changes.

* The company's management was removed from the liability of managing the investments. This freed up management to concentrate on the company's business and lessened company liability.

* The company's contribution, formerly going to the profit-sharing plan, now would be deposited into each employee's individual 401(k) account. This would allow each participant to manage the total of his or her retirement assets in keeping with the investment model that best suits that person's and their family's circumstance and risk tolerance level.

Also, the employer would be protected, as the employer contribution would retain the former vesting schedule.

* The employees, now managing the total of the employer and the employee contributions, would have 10 times the number of investment choices as previously. They also would have a 16-hour per day help desk and 24-hour Internet connection.

* The human resource administrative personnel of the company would be freed from the routine and time-consuming tasks of granting retirement plan loans, creating amortization schedules and answering administrative questions. This would all be accomplished via the plan provider Internet Web site and help desk.

* The employees and owners gain the employee financial education that the consultant provides so that they can fashion a cogent financial plan and implement it via their newly merged 401(k)/profit sharing plan. They also utilize that plan in making better fringe benefit program selections regarding insurance and discretionary deductions for their cafeteria plan.

The client adopted the recommendations, and Fragasso says the solution resulted in a 100 percent 401(k) plan participation rate immediately upon its implementation and the first financial education class presented to the employees.

For company owners and senior managers -- typically the highest-paid employees in the business -- low participation rates by employees put limits on the their own contributions because of nondiscrimination rules, which can cost them thousands of dollars over their careers. And with a properly devised plan, business owners can sock away a large chunk of money that won't be on the table when they want to sell their company.

"I can come away with hundreds of thousands, if not major seven figures in my retirement plan if I do it right," says Fragasso.

Fragasso suggests that business owners front-load time to put the right systems in place for their plan. Establish investment policy statements and guidelines, hire the right management for the plan and put in the right monitoring and communications systems. And, of course, hold people accountable for results, just as you would in any part of your business.

Says Fragasso: "It's a division of the business."

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