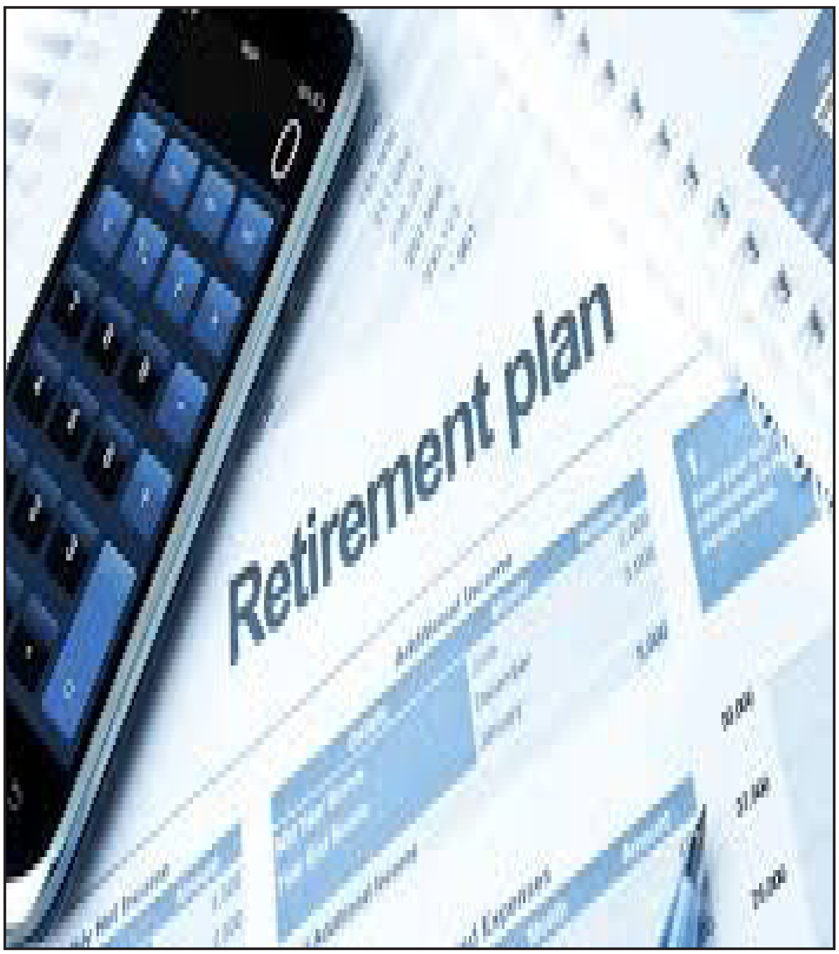
The Wrong Reasons For Hiring 401(k) Plan Providers

By Ary Rosenbaum, Esq.

Selecting a retirement plan provider can be a lot like dating in the sense that plan sponsors shouldn't pick providers for the wrong reasons. Nobody knows more about the wrong reasons for dating more than me; we call those wrong reasons: my brother-in-law and my former uncle. Seriously (I was serious in the last sentence), there are many reasons why plan sponsors pick certain providers and this article is going to tell you what are the wrong reasons are for doing so.

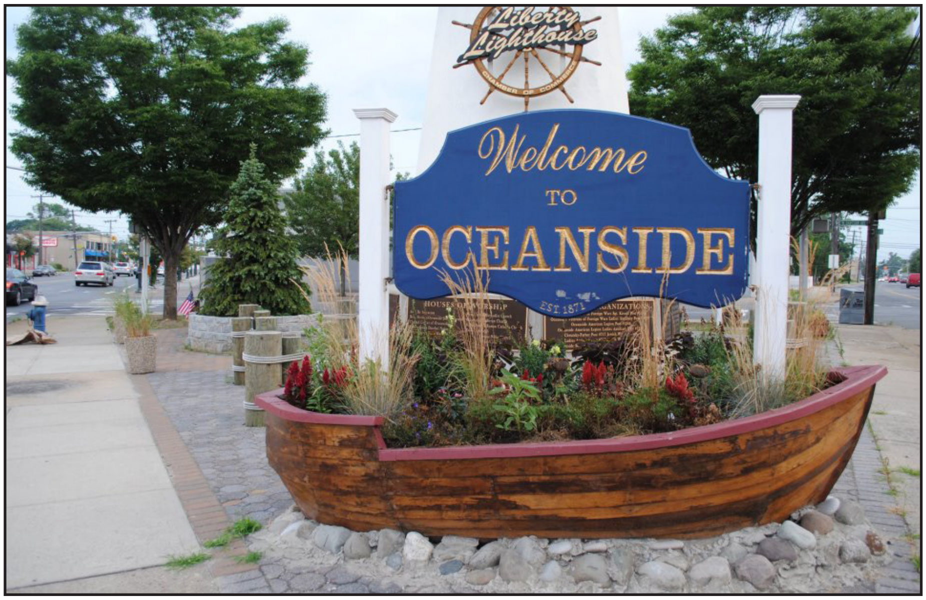


Picking a provider just because they're big

So many times a retirement plan sponsor will just pick a provider just because they're big. It's like they commissioned a list of the biggest plan providers and just decided to pick one. Bigger isn't better and just because something is popular doesn't make it good (just look at today's Billboard music charts). There are many reasons why a provider is large and it doesn't necessarily mean that they're very good at what they do. Heck I've seen the list of the largest third party administrators (TPAs) in terms of plans and there are TPAs on the list that I wouldn't refer my worst enemy to. Picking a provider just because they're big is a big mistake because the size of the provider doesn't mean that they're right for a particular plan. Some of the largest TPAs are great for the smaller plans, but can be a disaster for any plan where there is actually compliance testing. Some of the largest financial advisory practices aren't good fits for smaller plans. There are many reasons why a plan sponsor should pick a provider such as cost, expertise, demographics, and many other issues. Just because a provider is large isn't one of them.

Picking a TPA because they also do payroll

Marketing is a great technique because it can give you the impression that you really need something when you don't. One of the great marketing techniques in the retirement plan business is the idea that you should hire a TPA whose primary business is payroll. If you don't know anything about 401(k) plans, you would think that is a fantastic idea because most 401(k) contributions are employee salary deferrals. So it would make sense that a plan sponsor should hire a company that can handle both payroll and 401(k) plan administration. It's such great marketing because the two leading payroll companies in this country are also some of the largest TPAs out there. There are many reasons why you shouldn't hire a payroll provider as your TPA and I write an annual article that bothers those who work for these payroll provider TPAs. Outside of the fact that salary deferral contributions come out of payroll and payroll measures compensation, 401(k) administration and payroll have very little to do with each other. Payroll provider TPAs market much of their service in that they integrate their payroll service with their 401(k) TPA work and that it's seamless. If payroll integration is such a big thing, why do these payroll providers offer payroll integration to other TPAs? You don't see Kentucky Fried Chicken divulge the Colonel's secret recipe to Popeye's, so why would payroll provider TPAs offer payroll integration to other TPAs, which are the competition? It's because payroll provider TPA's bread and butter is payroll, TPA work is just an ancillary service. Based on the quality of the work that they do, payroll provider TPAs clearly show that their TPA work is just ancillary. A big portion of my business as an ERISA attorney is helping bail out plan sponsors that have compliance headaches at the hands of these payroll provider TPAs. The compliance headaches vary such as compliance tests done incorrectly, compliance testing not done at all, and annual Form 5500s not filed. Payroll provider TPAs offer no-frill service and don't offer the hand holding that most plan sponsors need. While I have been a vocal critic of payroll provider TPAs, I have to be an honest: their work is a boon to my business.



Picking a TPA just because you like their mutual funds

The growth of participant directed 401(k) plans and daily valuation was a great thing for mutual fund companies because it increased the distribution of their mutual funds, which fattened their bottom line through more assets that paid a management expense to the fund companies. So 401(k) plans were an effective means of distributing mutual funds, it made sense for mutual fund companies to offer bundled services and serve as a TPA. Most of these mutual fund companies do good work, but sometimes they aren't experts at plan design and combo plan design that unbundled TPAs are. Just because they like a specific mutual fund company doesn't mean that a plan sponsor should hire that company as the TPA for that reason only. There are many reasons why you should hire a TPA and just because they like a certain mutual fund company isn't reason alone to hire them as a TPA especially when any mutual fund is pretty much available in an unbundled situation. Another reason why picking a mutual fund company as a TPA is because it's assumed that you will select the proprietary mutual funds of that bundled mutual fund company TPA. Using proprietary mutual funds may conflict with a plan sponsor's fiduciary responsibility especially if those mutual funds underperform and/or are too expensive. There are several reasons why a plan sponsor may want to hire a mutual fund company TPA, but it has to be more than just the fact that they like their mutual funds.

Hiring providers because they're related

I live in an unincorporated village, so we have no Mayor. We have a group of people who are involved in the community, who control the school board. The members of the school board find nothing wrong with hiring their own relatives as school district employees. Nepotism for a family run business is expected, for taxpayer-funded jobs, not so much. When a plan sponsor is selecting a financial advisor or TPA, there are many reasons to consider hiring one and the hiring process must be rational using a variety of factors. Hiring someone just because they're related to one of the decision makers is a bad idea. Hiring the boss' wife as the financial advisor is a prohibited transaction because that hiring will certainly benefit the boss and these type of plan transactions can't benefit a fiduciary and/or the plan sponsor. Hiring a cousin may not be a prohibited transaction, but it certainly gives the appearance of impropriety in the hiring of plan providers.

Hiring providers that give the appearance of impropriety

In that incorporated village of mine, there are certain people who are juiced in and get to sell insurance to the school district, the library, or any other political subdivision they can control. It gives the impression that something is not on the up and up. The same can be said for hiring plan providers because there are certain hiring situations where it doesn't look right and if it doesn' look right, it may give a participant's attorney or the government the idea that something is wrong. Just ask Oracle who is being sued over their 401(k) plan because the mutual fund company TPA they hire happens to be one of the largest institutional shareholders of Oracle stock. Did Oracle hire this TPA because of that relationship? Maybe not, but it gave the appearance that something was not on the up and up. So many plan sponsors hire a financial advisor that happens to be employed by the bank that gives the plan sponsor their business line of credit. Is there a quid pro quo? Who knows? Who cares? A plan sponsor would be wise to avoid the question by not selecting a plan provider that suggests something improper was done.

Hiring a plan provider just because they're cheap

I've seen too many plan providers who select an advisor and/or TPA just because they're cheap. My experience has taught me that selecting a plan provider just because they're cheap ends up being costly. A plan sponsor has the fiduciary duty to only pay reasonable plan expenses, so that means they don't have to pay the lowest plan expenses. Plan sponsors need to hire competent plan providers because of the ultimate responsibility they have in being plan fiduciaries, so they can't afford to hire a plan provider just because they're cheap. There is nothing wrong with hiring a good provider who is cheap, but a plan sponsor needs to make sure the cheap provider is actually good.

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