Retirement Plan Provider Gimmicks All Employers Should Be Wary Of

By Ary Rosenbaum, Esq.

Back in the day when I was a kid growing up in Brooklyn (much scarier then in the 1970s and 80s), there was an electronics retailer named Crazy Eddie's. The commercials were memorable as the sales pitchman Jerry Carroll claimed that Crazy Eddie's price were insane. While the commercials were memorable, much of the advertising was misleading. When they would advertise a blowout price on an item, you would go to the store and always find out that the item was sold out (maybe they had 2-3 of these items in stock). Of course, Crazy Eddie imploded because of accounting fraud. The retirement plan industry often uses a lot of gimmicks and sales pitches to hook retirement plan sponsors without these sponsors really know what they are getting into. So this article is about the gimmicks and marketing sales pitches that plan sponsors should be wary of.

Your payroll provider as a TPA

It looks great on paper, having your payroll provider also function as your 401(k) plan's third party administrator (TPA). Crystal Pepsi looked great on paper too and then I tasted it. Aside from salary deferrals being deducted from a participant's paycheck and processed through payroll, 401(k) plan administration has nothing to do with payroll. Any form of retirement plan administration requires expertise and none of that expertise deals with payroll. So why do so many retirement plan sponsors hire their payroll provider as a TPA? Because most plan sponsors don't know what a TPA does and how a good TPA can keep plan sponsors out of compliance trouble, as well as maximizing employer contributions for a plan sponsor's highly compensated employees. Too many plan sponsors sell themselves short by utilizing a payroll provider as a TPA, especially if they are having plan compliance issues. Any retirement plan that has plan testing issues (especially when it comes to the lack of salary deferrals being made by rank and file employees) or wish to make an outside the box plan design, are making a mistake by falling for the gimmick that a payroll provider is the ideal TPA.

Assets under Management

In the movie Caddyshack, Judge Elihu Smails was incredulous that Ty Webb didn't keep score on the golf course. Smails asked Webb how he measured himself against other golfers and Ty said "by height". When it comes to financial advisors who work on retirement plans, they often advertise how many retirement plan assets they have under management. With all due respect to financial advisors who have large books of business, that fact in it and of it by itself, is meaningless since the purpose of a financial advisor is to help a retirement plan sponsor manage the fiduciary process. Assets under management are a nice statistic, indicative that a financial advisor has a large asset base and can probably afford that Mercedes, but it does not prove that said advisor is competent in managing the fiduciary process. There are many ways that a plan sponsors can evaluate a financial advisor such as experience, fees, investment philosophy, and approach to the fiduciary process of a retirement plan. Picking a financial advisor just based on their assets under management is a mistake and breach of a plan sponsor's fiduciary liability. Bigger does not necessarily mean better, especially when it comes to retirement plan providers.

Number of plans handled

Again, just like assets under management, this measure of how many plans a retirement plan provider handles is irrelevant as long as that number is higher than a few (you don't want a provider who handles one other plan, do you?). Two of the largest TPAs also happen to be two of the largest payroll providers. While these payroll providers tout the number of plans they handle, they are often silent about their client retention rate (or as I call it, a churn rate). A plan provider with a high churn rate indicates plan sponsor client dissatisfaction because it shows that a large amount of clients leave. So while saying how many plans they handle is nice, ask any potential plan provider what their churn rate is because that's more indicative of their competence. Hire a provider based on competence, not on size.

The Fiduciary Warranty

A warranty sounds like something nice, when a manufacturer puts out a warranty on their product because it means they stand behind their product. How much do you think the warranty is worth if the product never breaks or only covers defects in minor circumstances so that the warranty will never be used? Insurance companies offer fiduciary warranties and we all know that insurance companies make money by insuring risk. So how much is that warranty worth as insurance if they give it away for free? You get the drift. When plan sponsors hear the words "fiduciary warranty", I assume most plan sponsors think that these plan providers will either serve in some sort of a fiduciary capacity or indemnify the plan sponsor in any lawsuits brought by plan participants for any claim for a breach of fiduciary duty. Of course, these providers go out of their way to make sure that they are not identified as serving in any fiduciary capacity and the fine print in these warranties indicate that the providers will only defend plan sponsors in only in rare instances. The warranty only states that the investment options that this provider selected were prudent, satisfied the Section 404(c) requirement of offering a "broad range of investment alternatives", and that the investment strategies provide a suitable basis for plan participants to construct well diversified portfolios. That whole broad range requirement is rather broad; I am unaware of any plan fiduciaries ever being sued on that requirement. To comply with the simple broad range requirement, the plan fiduciaries must first decide on the asset classes (e.g., stocks and bonds) and styles (e.g., large cap U.S. equity growth fund, small cap U.S. equity value) for the "core" investments of the plan. So plan sponsors need to offer a diverse group of investments, which almost every plan does. A fiduciary warranty is almost absolutely no protection for plan fiduciaries, it's like buying car insurance that only covers you in a head on collision or a life insurance policy that only pays on accidental death. It's a warranty that warranties very little and that's why providers who offer it will give it to you for free.

Revenue Sharing

One of my favorite political moments was in 1980 when Ronald Reagan was sponsoring a Republican candidate's debate in Nashua, New Hampshire. Having sponsored the debate, Reagan was speaking into the microphone when the moderator instructed that it be turned off and Reagan yelled that "I am paying for this microphone". When it comes to revenue sharing, plan sponsors are already paying for it (actually the plan participants which includes some of the plan sponsor's decision makers). Revenue sharing payments are remuneration from certain mutual funds back to TPAs to offset administration expenses. These revenue sharing payments aren't free money because mutual fund companies charge administrative expenses for their funds and funds that pay revenue sharing are more expensive that funds that don't. For example, exchange traded funds and index mutual funds can't afford to make revenue sharing payments because their fund expenses are as much or less than the revenue sharing payments that other funds make. There is nothing wrong with revenue sharing funds as long as its disclosed, the problem is that plan sponsor don't understand that it really is a gimmick because plan participants are paying for that revenue sharing through the expense ratios of the funds in the plan. While it's nice that it's being used to pay down administrative expenses, but plan participants are paying for it through the funds in the plan. Beware of anyone claiming that something in the retirement plan industry because someone is paying for it, one way or another.

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