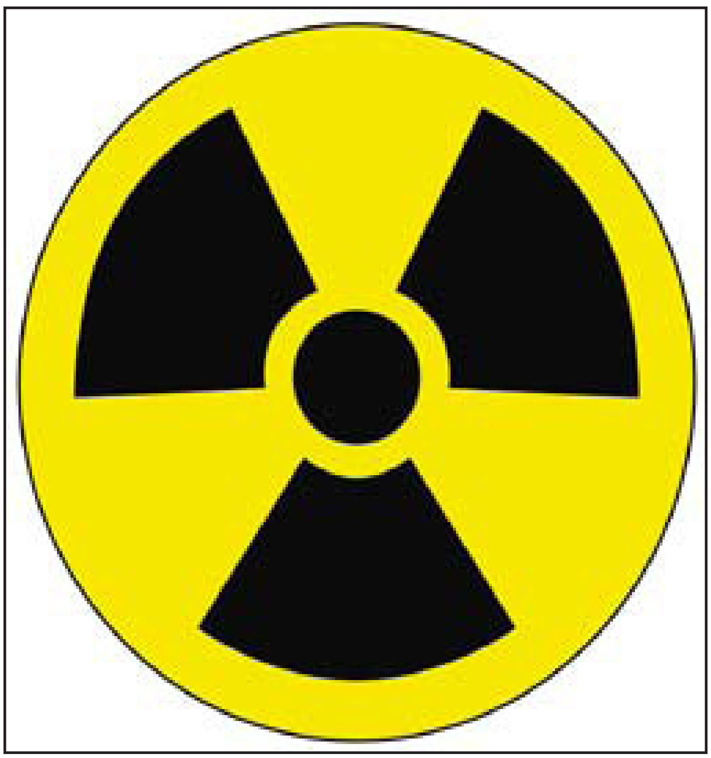
“Toxic” TPAs a 401(k) Plan Sponsor Should Avoid Hiring

By Ary Rosenbaum, Esq.

While most of the news about 401(k) plan fiduciaries and their responsibilities is about plan expenses, plan investments, and participant education, there is very little topic about the one issue that is important that most plan sponsors don’t consider. That consideration is the selection of the plan’s third party administrator (TPA) because the difference between a good and bad TPA can make or break a plan sponsor’s required resolve to uphold their responsibility as a plan fiduciary. While any review of a current or potential TPA will require diligence, there is a certain group of TPA or as I call it, “toxic” TPAs that plan sponsors should avoid.

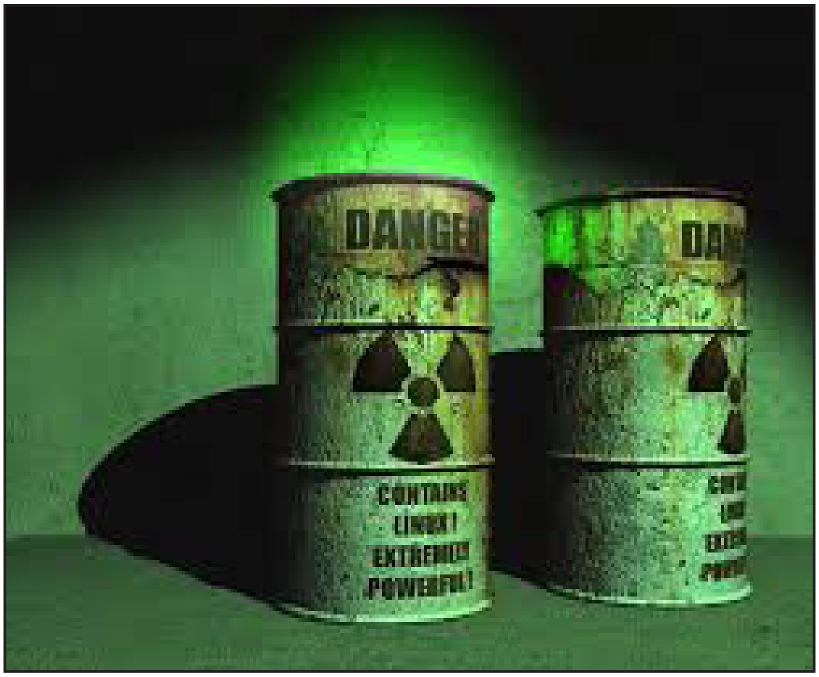


Payroll Provider TPAs

One of the breakthroughs in the growth of my business as an independent ERISA attorney was when I wrote an article criticizing the role of payroll providers serving as TPAs. This article and the annual sequels that followed detail my dislike of payroll providers being in the TPA because overall, they do not handle plan administration in a diligent manner. The payroll provider TPAs treat the plan administration business as ancillary to payroll and its shows. The fact is that plan administration has very little to do with payroll besides the segregation of 401(k) deferrals from payroll. Compliance testing, plan design, participant accounting, investment trading, and the preparation of Form 5500 are the bread and butter of what TPAs actually do. The payroll provider TPAs make too many plan administrative mistakes in the running of their compliance tests and their lack of plan design skills do not optimize a plan sponsor’s use of employer contributions which translates to less or wasted tax deductions. If an addition of a defined benefit would help a plan sponsor out, a payroll provider TPA can’t help them. While my distaste of payroll provider TPAs are well known, a small 401(k) plan with a safe harbor plan design (which eliminates most compliance testing) might be a good fit with a payroll provider TPA, most plan sponsors would be wise not to place their plans there. What the payroll provider TPAs forget to tell you is that they have a high churn rate (which means a high turnover of 401(k) clients) and if you end up firing them as a TPA, they usually take things personally by firing you as a payroll client. Honestly, my criticism of payroll provider TPAs is bad for my business because a nice chunk of my business is fixing the plan errors of 401(k) plans that terminated service with a payroll provider TPAs, the same can be said of the quality TPAs. While we criticizes payroll provider TPAs, we are biting the hands that feed because their errors and incompetence feed us quite nicely.

Bundled TPAs that push too much of their product

Many plan sponsors decide to have a well-known mutual fund company or insurance company to handle their plan administration. Having the same plan custodian handle plan administration sounds like a great idea, but it does raise some fiduciary concerns. Like payroll providers, mutual fund and insurance companies offer TPA services as an ancillary form of business. While their TPA services are ancillary to their role as plan custodians and investment managers, they do a more credible job than the payroll providers. The reason that the large mutual fund and insurance companies who serve as bundled providers are in the TPA business because it promotes the distribution of their product (plan investment options), and it cuts out the middlemen (unbundled TPAs and plan custodians) since they don’t have make revenue sharing payments to these providers. The caveat of using a bundled provider is because plan sponsors are going to have to use their proprietary investment options and being a responsible fiduciary is not about picking investment options just based on the fact that your plan provider owns it. Fact is that you’re not going to use Fidelity and not use their mutual funds just like you’re not going to a Pepsi distributor and not order any Pepsi products. The problem is that some bundled providers are pushier than others in the use of proprietary funds in a plan sponsor's lineup. I will never forget drafting a Retirement Plan Tune-Up (that inexpensive plan review for $750, cheap plug) and reviewing a 401(k) plan where every single mutual fund was the proprietary fund of the bundled TPA. Picking plan investment ifs about a process conducted by the plan fiduciaries and these decisions have to be what's best for the plan participants to direct their investments and just saying you picked the investment options just because they are proprietary funds of your plan provider isn't going to cut it. Plan fiduciaries need to select investment options that are the best in breed and no investment company is the best on breed mutual fund for every asset class. Plan sponsors need to be wary how much their investment lineup is dominated by proprietary funds. Just ask employees of Fidelity and MassMutual that are pursuing a class action lawsuit because their 401(k) plan investment lineups are dominated by proprietary funds. Out of 38 investment options on MassMutual's 401(k) lineup, employees allege 36 to 37 are MassMutual products. In the case against Fidelity, it's alleged that all investment options are Fidelity managed investments. Plan sponsors should treat proprietary funds the way people should treat food that's fattening for them, use in moderation.



TPAs who use confusing or a la carte pricing

One of the reasons that I use flat fee pricing for my clients is that I want them to have cost certainty and to know that there won't be some unnecessary add-ons. I've worked at law firms where they knock the clients by billing per the hour and then charging them for copies and other housekeeping services. I also worked for a law firm who charged clients for dinner that attorneys were eating while working the night at our offices. For me, the best TPAs are transparent and succinct in the explanation of their fees. While TPAs are required to disclose the fees they charge, some TPAs start charging extra fees such as excessive plan custodian fees and other unnecessary charges that a plan sponsor would only know were excessive if they benchmark those fees against a TPA that doesn't. I remember one TPA advertising they were charging a daily plan custodian fee of 25 basis points when I know the plan custodian was only charging about 10. In addition, there are TPAs that use a la carte pricing by advertising an artificially low base fee without explaining that necessary work performed by the TPA are treated as optional fees. I shouldn't pay extra for a steering wheel on a car and a plan sponsor shouldn't pay extra for a TPA to complete a 5500. A la carte charging is a problem because most plan sponsors don't fully understand what a TPA does and they may think that all they are responsible for is a base fee and not understand that the TPA's services also include these necessary add ons which may mean that they are paying more than they should have. A TPA client of mine was contacted by their client over a TPA that was advertising their $550 base fees A review of the fees by the TPA and client which included the necessary add ons, a change of TPAs would have cost this plan sponsor an additional $1,000 in fees. I'm not saying that TPAs that charge a la carte pricing are wrong, to me not including necessary TPA duties in a base fee of services is just a deceptive practice and a way of price gouging. I can't buy a MacBook without a keyboard, so why should a plan sponsor hire a TPA that doesn't include the preparation of a 5500 in their base fee.

A TPA out of their element

My wife and I expanded our house and we used a general contractor that we used in the past for our bathrooms and kitchen. It was clear from the start that this project exceeded their capabilities because they sub-contracted most of the work out, most of the sub-contractors were unlicensed, and they negligently handled the little work they did on their own. Had they been honorable men, they wouldn't have accepted a job above their capabilities. Too many times, a plan sponsors will hire a TPA that is not the right fit. A TPA that handles larger plans may not be the right TPA for a small plan especially if the minimum fee is too much. A defined benefit TPA may not know how to properly administer a 401(k) plan. A small TPA may not be able to handle the retirement plan of a Fortune 100 company. Too many TPAs try to be something that they are not and operate outside of their niche and scope of business; this is a disservice to the plan sponsor. A plan sponsor needs to hire a TPA that is the right fit. Heck, as discussed above, sometimes that maybe a payroll provider (rarely). The right relationship with the TPA is when the TPA fits the plan sponsor's needs in plan administration and that will happen when the service by the TPA meets the plan's needs.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw