Why Retirement Plan Sponsors Shouldn't Pick the "Cheapest" Plan Providers

By Ary Rosenbaum, Esq.

My wife loves a good bargain; I have lots of credit card bills to prove that. Seriously, my wife is an excellent shopper because she is a savvy shopper. My wife likes a good bargain and it's about value, getting something in quality that is on sale. Why buy something at retail price, when you can get in a few weeks at 30% less? The Lego City sets we get for my kids are much more enjoyable to us when it's 50% off than when it's retail. But a bargain is different than something that's cheap, a Lego City Bank set that's 50% off is a better value than the generic Lego knockoff that you see sold at the local 99 cents and up store. As a plan sponsor, you have a fiduciary responsibility to find a bargain when it comes to picking a plan provider, but you may increase your potential liability by picking providers just because they are cheap. This article is about why you shouldn't pick a plan provider just on low price.

Fee Disclosure can be a double-edged sword

Thanks to fee disclosure regulations finally being implemented, your retirement plan providers have to divulge to you the direct and indirect compensation that they receive for the services they will provide. The administration expenses of running a retirement plan (especially daily valued 401(k) plans) were usually cloaked with hidden fees and hidden reimbursement arrangements from mutual fund companies that led many retirement plan sponsors to believe that they were getting their services for a lot less than what was in reality or that they were getting it for free. Many in the industry feel that fee disclosures to plan sponsors and plan participants will become a double edged sword in the sense that plan sponsors will merely pick the plan providers just based on price and they will hire a third party administrator (TPA) or financial advisor that charge the lowest fees. That can be a double edged sword because many cheap providers aren't very good and any savings that you may get initially will cost you later down the line with increased liability because you will be responsible for the transgressions of your plan providers because of your role as a fiduciary.

Reasonableness doesn't mean cheap

As a plan fiduciary, you have a fiduciary duty to pay reasonable plan expenses. That does not mean you have to have low expenses, it means that the fees must be reasonable for the services to be provided. While paying unreasonable plan expenses is a breach of fiduciary duty, picking providers solely or mainly because they are low in fees can also breach the fiduciary duty. Retirement plan sponsors also have a duty of prudence as a one of their fiduciary duties. Prudence is about the process for making fiduciary decisions. Prudence requires the plan fiduciaries to document decisions and the basis for those decisions. Since most plan sponsors don't have the background to administer their retirement plan and make investments on their own, they need to hire the expert plan providers that can. So in hiring any plan provider, a fiduciary should survey a number of potential providers. By doing so, a fiduciary can document the process and make a meaningful comparison and selection. The duty of prudence requires the selection of competent plan providers and selecting an incompetent provider is a certain breach of that duty. So a plan sponsor needs to select competent plan providers that charge reasonable expenses.

Expertise doesn't come cheap

Do you pick your physician because they charge the lowest fee? Do you pick an attorney because he charges $25 an hour? Professional services aren't like buying a 2-liter bottle of Coke Zero where Target may charge $1 a bottle while your supermarket charges $1.79. Professional services are not grocery items; the difference in price can be a major difference in quality. Hiring your payroll provider to handle your 401(k) plan isn't a good idea if you intend to make contributions that favor the people running the business or if you want to offer benefits through a defined benefit plan or non-qualified deferred compensation plan. The cheaper TPAs tend not to have the level of sophistication when it comes to plan design. Lacking expertise in plan design can leave money on the table because not maximizing contributions to the plan for your employees can not maximize tax deductions for employer contributions, which puts more money in the pockets of the Federal and state governments. Also picking a financial advisor solely based on price is a bad idea. A financial advisor is supposed to help minimize your liability, so picking an advisor only because they're cheap isn't a great idea. The responsibility of a financial advisor for your plan is to help you manage the fiduciary process such as developing an investment policy statement (IPS), pick investment options based on that IPS, as well as offering investment education or advice to plan participants. An advisor who is hired because she charges 15 basis points (0.15%) who does none of the managing of the fiduciary process for you is more expensive in the long run than the investment advisor who is charging you 30 basis points and serving as a co-fiduciary because the liability exposure with the cheaper provider is that much greater than the one who is offering you the level of protection that you need. Whichever provider you select, price is a consideration, but making sure that these providers are offering you the breadth of services and liability protection are more important.

You want white glove treatment, pay for it.

You often what you pay for and picking the cheapest provider will yield the cheapest level of service. You will get concierge service at the Waldorf Astoria but you won't at Motel 6. There are plan providers that offer ERISA fiduciary services that can help minimize your liability because they are willing to shoulder the bulk of that liability. There are TPAs willing to serve as an ERISA §3(16) administrator, to take more of the liability that is inherent in the day-to-day plan administration of a retirement plan. A financial advisors maybe willing to serve as an ERISA §3(38) fiduciary and will assume the liability of managing the fiduciary component of your retirement plan. Invariably, providers offering this extra level protection of serving as an ERISA fiduciary for your Plan will cost more than the cheapest providers out there. Again, the question about fees is about reasonableness. You can pay more if you get more and you can pay less as long as you know you will likely be getting less. You want white glove treatment and that extra level of protection you can pay for it. If you want the white napkin treatment, you can pay for that too. Again, reasonableness is determined by looking at the fees for the level of service being provided, so you can hire a provider who will do more for you.

Make sure its apples to apples

With fee disclosure regulations, you have to review your plan providers and shop the plan around to determine whether the fees they are currently being charged are reasonable. When shopping or doing price comparisons, you should be aware of what your plan providers provide and only consider providers who could perform around that same level and breadth of service. Comparing your current TPA who does top notch work and intricate plan design to a payroll provider offering no-frills service isn't fair to your current provider or your plan because changing to a cheap provider who doesn't offer the same level of service is a step down that you and your plan participants will notice. You can't compare a Cadillac to a Chevrolet, but you can compare a Cadillac to a Lincoln, a Lexus, an Acura, and an Infiniti. By identifying the services that your incumbent plan providers provide and the fees they charge will give you an accurate sense of whether the fees are reasonable or not.

Focus most of all on competency

You need to focus on the competency of plan providers, the services they offer, and the value they provide. Concentrating just on how much a provider charges may cost you more in the long run if that provider provides services that are incompetent. I have seen too many plan sponsors forced into the Internal Revenue Service (IRS) or Department of Labor (DOL) correction programs to fix the errors of plan providers that were picked solely on cost. This is not to suggest that low cost providers are incompetent, it just means that the selection of a plan provider requires a careful process of evaluating them to find the best fit.

THE ROSENBAUM LAW FIRM P.C.

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