Plan Sponsors Need To Vet Any TPA Referral

By Ary Rosenbaum, Esq.

One of the most important things that a plan sponsor needs to do is hire a third party administrator (TPA) to help them handle the day-to-day of plan administration, compliance testing, and annual Form 5500 filing. Yet most plan sponsors don't vet TPAs before they hire them, often relying on the advice of a financial advisor who may not understand what a TPA does and why there is a need to hire a good one. This article is all about letting plan sponsor understand their need to vet their potential TPA and understand there is a different level of service between TPAs before it's too late.

What does a TPA do?

Not many plan sponsors understand, but a TPA is the most important plan provider they can hire. So it really is a head-scratcher that most plan sponsors don't evaluate any potential TPA before they hire them. It is the TPA that is the glue that holds the retirement plan together. The TPA handles the day-to-day administration of the plan, including distributions, discrimination testing, asset reconciliation, and governmental filings. The TPA ends up doing the bulk of the work on a plan and any errors on their side is usually what can cause trouble for the plan sponsor. Most issues on small to medium size plans are a result of administrative errors, so a plan sponsor needs to hire a TPA that can minimize the number of compliance errors. So that's another reason why a plan sponsor needs to properly vet any TPA they are considering hiring or reviewing based on a referral they received.

There are different levels of service that a TPA may offer

The problem for the plan sponsor in seeking out TPAs is that not every TPA offers the same level of service. Some may offer a bare-bones service and that's a problem when the plan sponsor doesn't understand and end up having a whole host of compliance issues because the TPA didn't offer the services that the plan sponsor really needed in order to continue the tax qualification of their plan. So a plan sponsor should understand the three different levels of services that a TPA could offer which I'll call TPA Light, TPA Basic, and TPA select.

TPA Light: Less Services And Doesn't Have A Great Taste

Lite Beer from Miller claimed their had less filling and tasted great. TPA Light offers very little services and plan sponsors should avoid hiring them. A TPA that offers a TPA Light level of service offers very little protection for plan sponsor in minimizing their liability and compliance issues. TPA Light offers a bare bone level of service, which means they only complete Form 5500 for the plan sponsor and pretty much nothing else. TPA Light doesn't perform the necessary compliance testing for plan sponsors including coverage, Top Heavy, and discrimination testing. They also don't go through the work of providing an annual valuation for the plan sponsors to review the inner workings of their plan. TPA Light is very busy in the prayer business because the bulk of their work is praying that the Internal Revenue Service (IRS) and/or the Department of Labor (DOL) doesn't audit the plan. Many years ago, I had a plan sponsor who used an actuarial firm for their defined benefit plan where the annual valuations weren't done and the DOL had the crazy idea that the plan sponsor has embezzled plan assets, which they didn't. The problem with hiring that TPA Light was that there was no backup for the plan sponsor to prove that the DOL was wrong. Unless the plan sponsor somehow knows how to complete compliance testing for retirement plans on their own, a plan sponsor should always avoid using a TPA Light.

TPA Basic: A Basic Level of Service

The second level of service that a TPA could offer is something that I call: TPA Basic. TPA Basic completes all basic services that a plan sponsor needs for the day-to-day administration of their plan. TPA Basic does have some of its drawbacks that a plan sponsor should understand. If a plan sponsor is utilizing a defined benefit plan, TPA Basic subcontracts the actuarial work to another provider. TPA Basic usually doesn't have an ERISA attorney on staff to review and draft plan documents. TPA Basic won't check the plan sponsor's census of employees and they won't verify data. TPA Basic also usually doesn't concern itself with the allocation of contributions. Most importantly, TPA Basic doesn't ask the plan sponsor for W2s and the W3 Form. The problem with not asking for W2 and/or W3 forms is that it won't find out if there are employees that should be covered under a retirement plan, but aren't. TPA Basic doesn't have the level of service that can eliminate all compliance errors because of all of the bases for competent plan administration. Plan sponsors that utilize a TPA Basic should understand that they need to be vigilant to cover the holes in the level of service that TPA Basic offers.

TPA Select is the white glove level of service

The top level of TPA service is what I call TPA Select. TPA Select means the TPA offers a white glove level of service where they perform from A-Z. They provide onsite actuarial work, they review all data, they review the census, and they will review the W2s and W3s. In addition, they will have an ERISA attorney on staff for all plan document and plan audit issues. TPA Select will be an expert on plan design, which will allow plan sponsors to maximize tax deductions and make employer contributions more efficient. TPA Select rarely make errors in compliance testing which is the most costly issues on plan audits. The white glove treatment goes a long way for plan sponsors to rest easy that the plan is being managed correctly when they have a TPA Select to rely on. Plans being handled by TPA Select as the TPA have fewer compliance issues and are more efficient in all aspects.

The problem with referrals

30 years ago, the bulk of referrals made for TPAs originated from attorneys and certified public accountants who understood the liability issues connected with poor plan administration. These days, most referrals for a TPA are made by financial advisors and retirement plan wholesalers. The problem with referrals coming from advisors and wholesalers is that many of them are unaware of what a TPA does and why a plan sponsor needs to hire a competent one. These advisors and wholesalers usually see a TPA as a price point, where they only select a TPA based on a price they have in mind. Too many advisors and wholesalers can't move past the idea that a TPA is nothing more than a price. TPAs are more than just a placeholder for a fee. They often don't understand that the TPA is something more than a service that has a fee attached. What a TPA selling is different from what other TPAs sell, they aren't selling the same tube of toothpaste. Every TPA has its own level of service and some have a better service than others. The point is that the level of service is more important than the fee. As I always state, a good TPA is the biggest difference between a plan having major compliance headaches and not. So a plan sponsor that merely relies on the referral of professionals who may not understand the value of a good TPA is putting themselves at risk.

Plan Sponsor need to vet a TPA

The most important plan provider that a plan sponsor can hire is a TPA. A TPA is the difference between a plan that is in compliance trouble and one that is not. So a plan sponsor can't just take the word of the advisor or wholesaler that made a referral. The plan sponsor should meet and interview any potential TPA, as well as reviewing the level of service they offer to make sure it fits the needs of the plan sponsor. A bad referral of a TPA will certainly put the person making it in a bad light, but it's the plan sponsor that will pay through the nose when there are compliance headaches to fix. A plan sponsor can't afford to take someone's word that a certain TPA is good, they need to make sure they are.

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