A Plan Advisor Should Be Careful About Their TPA Referrals

By Ary Rosenbaum, Esq.

Most financial advisors do a great job in stressing the needs to minimize a plan sponsor's fiduciary liability, yet it's still so amazing how so many pay so little attention to the third party administrator (TPA) they're referring their client to. One of the reasons they pay little attention to because they really don't understand that the TPA can be the major difference between a plan staying in compliance without huge penalties and not. Advisors also don't realize that referring a bad TPA can go a long way in getting the advisor fired. So this article is about how advisors should be concerned with the TPAs they hire.

An advisor should know what a TPA does

There are quite a few advisors who still don't understand what a TPA does and that's an absolute mistake and blind spot for an advisor's retirement plan practice. The reason why it can be such a blind spot is that there are advisors who understand the value of a good TPA. In a nutshell, a TPA is a third party administrator for a retirement plan. Advisors need to remember that the TP (TP, not teepee) in TPA means third party, so the plan sponsor is the plan administrator. That means that no matter what a terrible job the TPA may or may not do, the plan sponsor is responsible for those errors. Sure, a plan sponsor can sue any poor performing TPA, but plan participants and/or the Department of Labor (DOL) will still sue the plan sponsor if things go awry. That is why the TPA is the most important provider that a plan sponsor hires since the bulk of the problems that deal with the day-to-day plan administration involves errors caused by a TPA. That's why the TPA is the most important plan provider that a plan sponsor could hire and that's why an advisor should give great weight to which TPA they should refer rather than what many advisors do. A TPA is more than just a placeholder for a price When you're a financial advisor and working out proposals for potential plan sponsor clients, pricing is an important thing. This is the case especially when we're in an environment of fee disclosure, narrowing margins, and a highly competitive environment. However, financial advisors need to move past the idea that a third party administrator (TPA) is nothing more than a price.

They are more than just a placeholder for a fee.

The advisor needs to 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. It's all about reasonableness While many advisors just see a TPA as just a placeholder for a fee/price, they really miss the crux over the concern about fees. A plan sponsor has a fiduciary duty to only pay reasonable plan expenses. Reasonableness is determined by comparing the fee to the services provided. Many advisors and plan sponsors leave the service provided part of their fees analysis and just try to hire the TPA with the lowest price point. Unfortunately, in this business, you often get a lot for what you pay for and the cheapest TPA tend to offer the lowest level of service. There are TPAs that will just complete a Form 5500 and then do none of the required compliance testing. Of course, those TPAs charge the lowest fees but keep a plan sponsor in harm's way if there ever is an Internal Revenue Service or Department of Labor audit. Advisors need to focus less on the lowest fees and show more focus on the level of service because not all TPAs are created equal, there are many who offer a better level of service in terms of fewer compliance issues and plan design issues that put more money in the pockets of the highly compensated employees. Reasonableness on fees is really all dependent on service provided because paying the lowest fee for a TPA that provides the lowest level of service might be considered by some as a fiduciary breach

if that low-cost TPA does or does not do things that may hamper the plan's tax qualification as a tax-deferred qualified retirement plan.

Plan Design

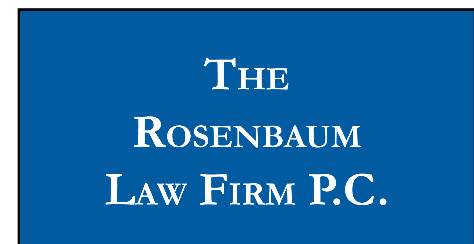
Advisors really need to understand that a good TPA is also good at plan design, which is an important issue. For the good TPAs, one of their great selling points is their sophistication in plan design. A good TPA will not only handle the administration and recordkeeping of the plans that their clients delegate to them, they can also design retirement plan programs that can maximize employer contributions to highly compensated employees (which includes the owners), which maximizes tax deductions. Maximizing tax deductions puts more money in your clients' pocket through retirement savings and less money in the pocket of government. There are too many TPAs out there who don't understand plan design, which may makes life for them easy but leaves money on the table for an advisor's clients. Retirement savings don't have to build on 401(k) salary deferrals alone. There are other plan design options that can help maximize savings through increased contributions to highly compensated employees. That may be a safe harbor 401(k), new comparability/cross tested design, a floor-offset arrangement, a cash balance or defined benefit plan, and a nonqualified plan to name a few as plan design options. I believe that an advisor who only refers TPAs that only handle 401(k) plans is not doing right by their plan sponsor clients because it may leave a lot of money on the table through lost opportunities to maximize contributions, tax deductions, and retirement savings by not looking at something other than 401(k) plans. A bad referral will get an advisor fired Advisors should really be concerned with who they hire through a referral because a bad referral is a good reason why advisors get fired by the plan sponsor. An advisor who refers a TPA that causes compliance errors that threaten the plan's tax disqualification and may require corrective contributions and penalties to fix may get fired as a result of the bad referral. When someone makes a bad restaurant recommendation, all may result is a bad meal. A bad TPA recommendation is a lot costlier than a bad meal.

A bad referral will get an advisor fired

Advisors should really be concerned with who they hire through a referral because a bad referral is a good reason why advisors get fired by the plan sponsor. An advisor who refers a TPA that causes compliance errors that threaten the plan's tax disqualification and may require corrective contributions and penalties to fix may get fired as a result of the bad referral. When someone makes a bad restaurant recommendation, all may result is a bad meal. A bad TPA recommendation is a lot costlier than a bad meal. Bad referrals can cost the plan sponsor a lot of money and sleepless nights. That is why an advisor should vet who they refer and make sure the TPAs they refer have a level of service that is consistent with good practices and correct compliance work.

Refer more than one TPA

When it comes to referring TPAs, advisors need to understand that there is no TPA that is going to be the right fit for every plan they handle. That might be because of plan size and plan type. That being said, from a practical standpoint, it is never a good idea for an advisor to only refer one TPA based on the belief that "you shouldn't have all your eggs in one basket." If an advisor only refers clients to one TPA and the advisor finds out working that TPA is no longer a good idea because of their incompetence, then the advisor's entire block of business is at risk. I once worked with an advisor and every few years, he migrated his entire book of business to another TPA after there was some type of large miscue involving one or more of the plans that the advisor had at the current TPA. In an ideal world, an advisor should house all their clients' plans in one TPA, but the fact is that the nature of the retirement plan business and good business sense won't allow that. One investment advisor may make have the client select an unbundled advisor because their advisor has all their clients' assets custodied at a specific custodian that the unbundled TPA uses. While getting paid is important, selecting a TPA just because an advisor can get paid easier is not a good idea. A TPA is responsible for helping the plan sponsor preserve the tax qualification of the retirement plan by performing all the administrative duties that the plan sponsor has delegated to the TPA. So on the other hand, an advisor should keep the TPAs they work with to a handful because when they have a dozen or so TPAs, things can certainly get confusing.



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