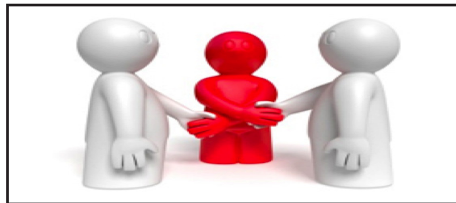
Plan Sponsors Need To Vet Any Potential TPA

By Ary Rosenbaum, Esq.

A common mistake made by a plan sponsor is to hire a Third-Party Administrator (TPA) that was recommended by a financial advisor based on low fees. 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. Hiring a TPA to is much like hiring a CPA. The term 401(k) is an Internal Revenue Code Section. Employer contributions to a plan are excluded from taxable income under U.S. Code Section 404. Employee Salary Deferrals are governed by U.S. Code 402(g), for annual additions then refer to U.S. Code 415, compensation under U.S. Code 401(a)(17) and many others that if I have to list, the article's title would be called IRS, DOL, and PBGC law. Many plan sponsors forget that the Department of Labor has jurisdiction over qualified plans. The Employee Benefits Security Administration is in charge of the enforcement of their laws and regulations. Their concern is the protection of the participant. So it really is a head-scratcher that most plan sponsors don't evaluate any potential TPA before they hire them. When a business owner hires a bank, the banker does not say, "I can find you a cheap accountant", yet the referral practice is pervasive in the industry. For a business, you can hire a tax CPA, an Enrolled Agent, an accountant, a local tax processor or a friend that can help you file your business return. Only when you get an audit is when you realize what you have done and by then it is too late. Plan sponsors that select low-cost administrators referred by financial advisors usually end up picking up the tab when a participant complains or upon audit by a government entity. Plans that are qualified can be disqualified by IRS upon audit or TPAs that don't know what they are doing. A disqualified plan will cause the trust to be subject to taxation and at the end of the day more than 100% of the trust will end up in the hands of IRS and lawyers defending the plan sponsor. When you add the Department of Labor Fiduciary



breach valuations, the penalties can cause the loss of the business. Just Google Fiduciary breach civil and criminal violations. 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 calculations of deductible contributions, verification of the deductibility of such contributions, trust accounting and asset reconciliation, determination of actual eligible compensation, vesting calculations, compliance testing, non-discrimination testing, participant disclosures, governmental filings among other things. The TPA ends up doing the bulk of the work on a plan and any errors made by the plan sponsor or the TPA can cause trouble for the plan sponsor. In the retirement industry, financial advisors earn their income based on plan assets. In addition, recordkeepers also earn a living based on the amount of money invested. It is no secret that when the financial industry wants to grow their asset base, they look for "cheap" TPAs to get the client not knowing if the person or company is competent. An advisor can make a recommendation; however, the advisor needs to asses a TPA before such recommendation. I don't know anyone that would refer a brain surgeon based on fees, so why would anyone refer a tax practitioner based on fees. Good TPAs can minimize the number of compliance errors made by plan sponsors and avoid Fiduciary breach violations. After many years in the industry, I have seen different compliance levels for the same types of plans. Some TPAs administer plans in the way prescribed by the Employee Retirement Income Security Act (ERISA), most TPAs cut corners to lower fees and pass the burden of compliance to unsuspecting HR managers or controllers that simply don't want to do what they have to or don't understand. Others simply should not be in the industry.

There are different levels of services

The problem for the plan sponsor in seeking out TPAs is that not every TPA offers the same level of service and most providers spreadsheet the fees not knowing the difference among various TPAs. 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 barebone level of service, which means they only complete Form 5500 for the plan sponsor and processes distributions 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 and unfortunately, it is the bulk of administrators in the country. 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 against W-2s and W-2, Schedule C or K-1 for partnerships, and they won't verify data. TPA Basic also usually doesn't concern itself with the allocation of contributions nor do they care what the CPA deducts on the business return. Most importantly, they copy the investment reports directly to IRS/DOL Form 5500. This service is like your CPA copying your annual bank statements directly to the tax return without adjusting entries. One TPA I know found thousands of dollars that were due to the plan, reported by a payroll plan on prior reports but never deposited by the plan sponsor. Yet the 5500 forms were filed on a cash basis. In other cases, money was stolen by a controller, simply because the prior TPA did not reconcile assets. Some TPAs claim they do but, they provide the investment reports as their own. 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. In other words, start learning the tax code and DOL regulations.

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 on-site actuarial work, they review all data, they review the census, and they will review the W2s and W3s. For example, if compensation for an employee drops, they may call you asking if the person terminated. If they see a 14-year-old making $80k in salary they know a date of birth may be incorrect. They check for changes in demographics among many other things. In addition, they will have an ERISA attorney on staff for all plan documents and plan audit issues. They will employ Enroll Actuaries for defined benefit work as opposed to subcontracting work. 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 expensive issue 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 looking to meet sales quotas and 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 a 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.

THE ROSENBAUM LAW FIRM P.C.

Copyright, 2018 The Rosenbaum Law Firm P.C.
All rights reserved.
Attorney Advertising. Prior results do not guarantee similar outcome.

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