It Looks Good On Paper For The 401(k) Plan Sponsor, But…

By Ary Rosenbaum, Esq.

Often there are things that look good on paper and don't look good in practice like an Apple Newton or Incredible Universe. Those business bombs cost the businesses that pushed them out. For 401(k) plan sponsors, they can ill afford to implement practices and procedures that look good on paper, they need to understand that in practice doesn't look as good as paper.

Payroll and TPA services have little to do with each other

The two top payroll providers out there offer TPA services and it's brilliant that they do. Through some good marketing, they have plan sponsors convinced that hiring a payroll provider as their TPA is a great idea. In reality, it isn't. Aside from salary deferrals taken from payroll, payroll and plan administration have little in common. Payroll provider TPAs also tout the seamless integration between payroll and their TPA services but forget to mention that they offer that same integration with other TPA providers. I always get flack from people who work for payroll provider TPAs for my comments and like bounty hunting, it's a living. (obligatory Outlaw Josey Wales line). My practice concerns all aspects of qualified and non-qualified plans and a big part of that job is fixing plans that are out of compliance. Most plans that are out of compliance are plans that were former clients of payroll provider TPAs. It's not that payroll provider TPAs can't do a competent job of plan administration, it's just that their approach to day to day plan administration makes me wary of ever recommending clients to them. Other companies out there that offer TPA services as an ancillary part of their business (mutual fund companies and insurance companies) don't have has many compliance issues that payroll provider TPAs. I find payroll provider TPAs to be lacking in communicating with plan sponsor clients and assuming that clients know more than they really do, such as simply filling out an end of year questionnaire. I also feel that when it comes to plan design issues, payroll provider TPAs are behind the curve. A good TPA is pro-active, payroll provider TPAs tend to be reactive. It's my view that any 401(k) plan that isn't safe harbor and has to go through all the compliance tests that safe harbor plans avoid, should consider TPAs that have a better track record of servicing the compliance needs of their plan sponsor clients.

Revenue sharing paying funds reduce plan administrative expenses or does it?

Prior to fee disclosure regulations in 2012 that required plan providers to disclose to plan sponsors how much they were charging for plan expenses, plan sponsors only knew what the plan was paid based on what the plan providers were telling them. So if a broker made extra money by pushing a specific fund or a TPA was pushing for specific funds to get more help in pricing and didn't want to tell the plan sponsor, they didn't have to. The problem was that 401(k) plan sponsors have a fiduciary duty to pay reasonable plan expenses and they can't determine that if they don't know. One place where plan sponsors had no idea was the predominant use of revenue sharing paying funds. Some mutual funds pay revenue sharing where they send fees to a TPA to offset plan expenses because the TPA was now doing the recordkeeping, rather than the mutual fund directly. On paper, it does seem fair except for one big thing: not every mutual fund paid revenue sharing. One of the many reasons why not every mutual fund pays revenue sharing is that some have such low plan expenses such as index funds can't. An index fund with a 10 basis point administrative expense can't pay the 25 basis points revenue sharing to TPAs if they want to stay in business. The problem with revenue sharing paying funds was that many TPAs and advisor were pushing it because they claimed it would offset expenses and forgot to tell them the problem on the backend: that revenue sharing paying funds tend to

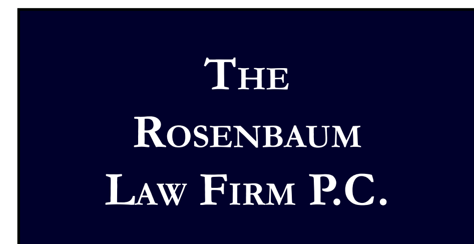
have higher expenses than plans who don't. The other problem is that many TPAs and advisor were pushing revenue sharing funds with the main reason that they paid revenue sharing. Thanks to fee disclosure regulations and plan litigation, the truth about revenue sharing funds are out there. Disclosure requirements allow plan sponsors to finally understand the true cost of revenue sharing in how it does reduce plan expenses but has higher fund expenses. In addition, litigation has made most plan sponsors very wary of using revenue sharing paying funds because large plans have been successfully sued for offering them. I'm not going to say that 401(k) plans should never use revenue sharing paying funds because only a Sith deals in absolutes (obligatory Star Wars reference). A plan sponsor can use revenue sharing paying funds as long as revenue sharing is just one of many reasons to use a particular fund and that reason needs to be at the bottom list of reasons. As long as a plan sponsor can articulate the reason for choosing a fund and the main reasons isn't that it pays revenue sharing, a plan sponsor should be find because courts have recognized that using revenue sharing paying funds isn't reason enough to hold plan sponsors liable in litigation, there has to be more there. Like eating red meat, plan sponsors should limit using revenue sharing paying funds for the overall health of their 401(k) plan.

The participant directed 401(k) plan is supposed to limit liability

Technological innovations in computers and especially the Internet allowed for the proliferation of participant-directed 401(k) plans in the 1990s when most plans up until that time were trustee directed. The move to participant-directed plans was heavily pushed by mutual fund companies who wanted a bigger share of the 401(k) plan assets. So there was a push for participant-directed plans with the advertisement that ERISA §404(c) limits a plan sponsor's liability for losses in a participant's account if the participant-directed their own investment. Remember pharmaceutical television advertisements before they disclosed the side effects, well let's just say that ERISA §404(c) plans are usually advertised without the side effects. There are many 401(k) plans out there that assume they are not liable for the losses incurred by plan participants just because they give participants the right to self-direct plan investments. That's because their providers neglected that liability protection under ERISA §404(c) is only offered as long as plan sponsors put participants in a position where they can make informed investment decisions. I always use it as an example, but my old law firm offered participants the right to self-direct their investments without properly educating them and offering mutual funds on the 401(k) lineup that wasn't updated for 10 years because they didn't use an advisor. I helped fix that because the law firm would have been fully liable for losses incurred by participants because they were breaching their fiduciary liability. To really get that liability protection, 401(k) plan sponsors need to hire an investment advisor that will help implement a prudent fiduciary process and offer investment education to plan participants. The fiduciary process requires an investment policy statement, timely reviews of plan investments, offering investment education and/or advice to plan participants, and for the plan sponsor to document all the steps needed for ERISA §404(c) plans to get that protection. That protection isn't all or nothing, it's a sliding scale of protection based on how little and how much that plan sponsors do as part of a prudent fiduciary process.

They can wear all the hats, but should they?

There are a lot of TPAs that really know how to create a synergy by not only offering thirty party administration/recordkeeping services, but also legal document services, financial advisory services, and ERISA §3(16) named plan administrator services. These type of TPAs are ingenious when it comes to trying to make a nickel through their services because they have covered almost all of the bases when it comes to retirement plan service (they can't offer independent audits). Just because a TPA can offer almost every plan service manageable, there isn't a need to hire them to perform all of them. I'm sure these TPAs do good work, but a plan sponsor would be at a disadvantage if they put all their eggs in one basket especially when something goes wrong. I believe that a plan sponsor should always have a system of checks and balances, so that means that they shouldn't have one provider wearing all the hats, they should have at least two independent providers. I used to caution plan sponsors about using a "producing " TPA, a TPA that offers investment advisory services. That caution was before the days of fee disclosure regulations and when revenue sharing was a bigger deal. These days, my advice is that plan sponsor should have at least two plan providers who are independent of each other, just so there is a system where a provider can check on the other.



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