Retirement Plan Provider Gimmicks You Need To Be Aware Of

By Ary Rosenbaum, Esq.

The retirement plan business is heavily competitive and so much of that deals with marketing. As a retirement plan sponsor, you need to separate the fluff from the real stuff. You also need to understand what is a sales gimmick and what is something of substance. When it comes to the retirement plan business, I am the turd in the punch bowl because I have a problem of telling it like it is. I'm about to let you in on what is just marketing and sales gimmicks.

Free services for some time

There is no bigger marketing gimmick than offering free services for a certain period. I would remember seeing a gym offering a free workout and the moment you entered the gym, it was going to be one giant sales pitch with about 10 minutes of actual workout time. Netflix built their original DVD rental business by offering free rentals when you bought a DVD machine. Free services are a way that some companies do business in acquiring new customers. In the retirement plan space, many providers such as a third-party administrator (TPA) may offer a certain time of free service as part of their contract. Free services for a gym might be nice, the same it did with free DVD rentals. As a retirement plan fiduciary, you can't fall for a gimmick like that. There are many reasons why you should pick a TPA, free plan year quarter or six months of service isn't one of them. ERISA requires plan fiduciaries to be prudent, so that means that decisions need to be prudent and rational. Free services don't make the list of good reasons to hire a certain TPA. Free services are a gimmick, as any provider that doesn't want to lose their shirt in offering free services has banked that cost of that in their fee going forward.

Warranties

Insurance companies are in the business of insuring risk. What would you say if an insurance policy was free? While many people would think that's great value, but free insurance policies means very little risk. So there are many retirement plan providers out there that offer free warranties. These warranties aren't that much in vogue anymore, but I still know a few providers that still offer them. The nature of the warranty is that the provider (usually an insurance company owned platform of investments) will indemnify the plan sponsor from any losses from litigation concerning the selection of plan investments for a plan where participants direct their investments under ERISA §404(c). The problem is that the indemnification only covers a small sliver of the investment selection process, the "broad range" of investment options requirement. "A broad range is defined as at least three investment alternatives, that's it. To steal a line from Commander Montgomery Scott in Star Trek III; The Search for Spock, a chimpanzee, and two trainees can satisfy that requirement. One doesn't have to go to Wharton or work in a brokerage firm to be able to select three different kinds of mutual funds. I've been an ERISA attorney and I can't remember where a plan sponsor was sued for failing to select enough investment options to satisfy the broad range requirement. When a plan sponsor is usually sued over not having a broad selection of investments, it's over a plan where the trustee directs investments and too much of the investments are in company stock. Fiduciary warranties aren't worth the paper they're written on. As the turd in the punch bowl, I get a lot of heat for being honest about this. I remember when the local salesman of a well-known insurance company provider said he wasn't going to refer me any business because of an article I wrote. The only problem was that he never referred me any work, so I didn't lose anything from it. A fiduciary warranty is like lightning insurance, the chances where you will be covered as a plan sponsor is extremely remote. Use common sense, fiduciary liability policies cost money, fiduciary warranties don't and there is a reason why. The reason is that a fiduciary liability policy will protect you because there is a risk, there is no risk of a fiduciary warranty being used.

Payroll providers as 401(k) TPAs

Pepsi is one of those great companies because they realized that there were certain other business areas that they could venture into and use to further distribute their soda products. A perfect example of that is when they owned Pizza Hut, Taco Bell, and Kentucky Fried Chicken (which were all spun off to their own separate company). In the retirement plan business, major fund companies such as Fidelity, Vanguard, and T. Rowe Price went into their 401(k) TPA business because it was an effective means of distributing their bread and butter, which is their in-house mutual funds. These fund companies have done a credible job as 401(k) TPAs. Payroll companies, especially the two top companies in the country are also two of the largest 401(k) TPAs. Unlike the mutual fund companies, these payroll providers have not done a very good job as 401(k) TPAs. Payroll provider TPAs are very good at marketing because they have convinced many plan sponsors and their financial advisors that there is some important connection between payroll and 401(k) plans. Payroll is important to 401(k) plans because the bulk of contributions come from salary deferrals from payroll. Payroll data also has to be correct, especially when it comes to determining compensation for plan purposes. However, payroll providers overstate the nexus between payroll and 401(k) administration. Also, they stress the importance of 360 integration between payroll and TPA services. The only problem is that these top payroll providers also offer this 360 integration to many TPAs including some of their largest competitors for TPA services. 360 integration doesn't mean anything to me as an ERISA attorney if the TPA services are poor. I have found poor service by these payroll providers with plans that aren't safe harbor 401(k) plans (hard to screw up plans with few compliance tests). Payroll provider TPAs expect too much out of clients because they provide little help in many important tasks, such as year-end census information. I have found that these payroll provider TPAs make too many catastrophic errors in compliance testing and/or administrative tasks that put plan sponsors at risk. While payroll provider TPAs will say I'm biased, I am because it's based on 23 years of experience. While I don't get referrals from payroll provider TPAs because of my opinions (turd in the punch bowl), I do well with their former clients in terms of plan audits, self-correction, and submission to the Internal Revenue Service (IRS) Voluntary Compliance Program (VCP).

The TPA termination fee

If I change doctors, my old doctor isn't going to charge me a termination fee (they may charge me for copies of medical records), the same thing with my mechanic. Yet TPAs charge a termination fee for any plan sponsor client that fires them. I have a few problems with that. First off, I don't know many TPAs that disclose the termination fee when the client first signs their contract for services. I'm a big fan of transparency and that fee should be fully disclosed. I've seen situations where the old TPA charged a bloated termination fee because they wanted to punish the soon to be a former client. No business relationship will last forever and ultimately, a TPA is going to lose that client one way or the other. The termination fee should be built into the TPA's fee because it's inevitable that the client will fire them or end up terminating their plan through merger, purchase, or ending the business. Since every plan will eventually terminate that TPA for one reason or another, it doesn't seem fair for TPAs to charge a fee for a client leaving. I understand that the termination fee is something that will never go away. Since I won't win that battle, I will stress that the termination fee should be fully disclosed at contract signing. Plan sponsors like you should know what will cost them to leave a TPA at the outset, instead of waiting for that sticker shock when the termination letter is sent.

On-staff attorneys

TPAs and advisors have attorneys on staff. I know, I worked for TPAs for 9 years. The problem with staff attorneys is that plan sponsors like you may not understand that staff attorneys for your plan providers can't represent you fully because they can't offer you an attorney-client relationship. For example, a TPA attorney can certainly be helpful to a plan sponsor client, but there is a limit. The ethical obligation for the ERISA attorney working for a TPA or a financial advisor belongs to the people who sign their paycheck. As a solo ERISA attorney, my obligation belongs to my client. A perfect example recently over the issues with staff ERISA attorneys is when a plan sponsor had an issue regarding missing adoption agreements for related employers. My guidance was that the plan should be submitted to the IRS VCP program. The TPA's attorney, who wanted to minimize their company's exposure, said the retroactive amendment (8 years) could be accomplished through self-correction, When I was a TPA attorney, a good chunk of my time was helping our clients, but also trying to limit the liability of my company in the way they administered retirement plans. There is always a need for staff ERISA attorneys, but they need to be transparent that their advice can be biased and that there is no attorney-client relationship.

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