In our lives, there are times when we have two important choices. It’s Coke vs. Pepsi, Mac vs. PC, Xbox vs. PlayStation (sorry Nintendo), Star Wars vs. Star Trek, and Marvel vs. DC. In the 401(k) space, it’s always bundled vs. unbundled for the employer to choose as a 401(k) plan provider. So this article will discuss the bundled vs. unbundled debate and what may be the better fit for a particular 401(k) plan.

The idea behind bundled providers
The idea behind bundled providers is two fold; one for the consumer plan sponsor and one for the provider offering the service. For the plan sponsor, using a bundled provider is all about one stop shopping, the ability to use one provider to be the plan custodian, third party administrator, and record-keeper. For the bundled provider, the idea to be in the TPA business is because it’s all about distribution. Distribution meaning the distribution of mutual funds because most bundled providers are in the mutual fund business. So Fidelity, American Funds, and the other fund companies, offering bundled services allows for more distribution of their mutual funds and it might be a cost savings to them since they don’t have to remit any remuneration that they may have to send to an independent TPA as part of revenue sharing or recordkeeping fees. By keeping TPA services in-house, it’s an economical way to make their mutual funds more readily available in 401(k) fund lineups that drives up their assets under management and boost revenue through the management expenses they charge through each mutual fund.

The idea behind unbundled providers
The idea behind unbundled providers is the ability for plan sponsor to have choice. Using several different providers allows plan sponsors the ability to pick and choose the plan providers they feel comfortable to work with. By picking one particular TPA may offer the plan sponsor a half dozen to a dozen different platforms and custodians, including those providers who offer bundled services such as Fidelity and Vanguard. The choice of platforms and custodians is dependent on the TPA as well as the cost that is usually dependent on the size of the plan’s assets. Unbundled TPAs also offer more choices in plan design and plan choices that can also help augment the retirement plan savings of the employer and the participants in the plan.

There are no absolutes as to what the best provider is
While I have strong bias for unbundled providers as an ERISA attorney because of my work for unbundled TPAs, the fact is that bundled providers do serve a purpose in the 401(k) marketplace. Bundled providers can be attractive for newly created plans that have little or no assets. Bundled provider costs are generally lower than unbundled providers for these plans because the provider is able to offset recordkeeping and administrative costs from investment management fees. The problem with the bundled provider approach is that too often; many 401(k) plan sponsors have outlived the usefulness of bundled providers by paying more than they would for unbundled providers while getting less in investment offerings, plan design, and a level of administrative service. However for many plan sponsors, the idea of one stop shopping for all plan services is very attractive because for them it’s less stressful than dealing with multiple providers. The choice of using a bundled or unbundled provider should be about the reasonableness of its fees based on the service that the unbundled or bundled provider provides. It’s like buying a suit, finding the provider that is the right fit.

Bundled Providers and The Myth of Free Administration
In the old days before fee disclosure, bundled providers were that much more attractive because plan sponsors assumed the TPA services the bundled provider was offering was free. It wasn’t, it’s just
that there was absolutely no transparency from the bundled provider and they did very little in discounting the incorrect notion that plan sponsors had. The fact is that if it wasn’t for the bundled provider approach, there may never have been a reason for the Department of Labor (DOL) to require the disclosure of retirement plan provider fees to plan sponsors. The myth of 401(k) administration is what I believe the largest misconception that plan sponsors have, the myth that they actually pay nothing for the administration of their plan. For example, many bundled providers are insurance companies. What created the myth of free 401(k) administration is the fact that bundled providers had much lower base and per participant fees than unbundled providers, so plan sponsors thought they were saving money. What plan sponsors were not aware of was that there was a wrap fee for these small plans. The wrap fee is an extra charge hidden in the mutual funds offered in the plan that the plan sponsor never knew was there. For the bundled providers that are mutual fund companies, the mutual fund companies were holding on to the sub t/a and revenue sharing fees that they would have to give to an unbundled TPA is a plan sponsor picked unbundled providers. Thanks to fee disclosure, the myth has been discounted because any direct or indirect compensation any type of provider (bundled or unbundled) receives must be disclosed to plan sponsors. Plan sponsors need to review their fee disclosures to determine the reasonableness of fees, regardless of the provider approach they selected.

The extra cost of the bundled provider
Again, one stop shopping is a great concept, but there is an additional cost of taking the bundled provider approach. While bundled providers do offer a low cost option for many 401(k) plans, they do so at a very large cost that plan sponsors are unaware of. Unlike unbundled providers, bundled providers have a very small menu of available mutual funds from a very small amount of fund families. Let’s be honest, a plan sponsor isn’t using Fidelity as a bundled provider to select all Vanguard funds. There is some sort of wink wink acknowledgement that if a mutual funds company is the bundled provider, many of their funds will be selected as part of the fund lineup which always the risk of the plan sponsor being accused of breaching their fiduciary responsibility. In addition, many of the insurance company bundled providers usually require a surrender charge, namely and end load penalty on plan assets if the plan sponsor terminates the relationship with the bundled provider before a certain period (usually 5-6 years) ends.

Plan design issues
If a plan sponsors has a straight plain vanilla 401(k) plan with no compliance issues, a bundled provider is usually an excellent choice. However if the plan has compliance issues or wants a unique form of plan design, bundled providers are at a severe disadvantage when it compares to unbundled providers. Bundled providers offer what I call a “box approach” to administering retirement plans. All the plan sponsors it services must have their retirement plans fit in their box, even if fitting into that box is a disadvantage to the plan sponsor. The box is dictated by prototype plan documents that offer a cookie cutter approach to plan design issues. While the cookie cutter approach to plan design may work well for 50-75% of the retirement plans out there, there are so many plan sponsors that leave money at the table if they use a bundled provider. One of the larger parts of my business as an ERISA attorney is trying to fit a plan sponsor who uses a bundled provider outside that box. Whether it’s an amendment allowing a new comparability plan design or setting up a trust to hold life insurance contracts, a big part of my work is helping plan sponsors out because their bundled providers can’t. When it comes to plan design, the actions of bundled providers are rather limited because they are attached to that box. Unbundled providers have no allegiance to any boxes, they will customize plan design specific to the needs of every plan sponsor. Those needs may be a non-safe harbor form of profit sharing allocation or using a form of a defined benefit plan or a non-qualified plan in connection with a 401(k) plan. For many bundled providers, if the Plan does not contain a 401(k) feature, their box won’t let them offer it.

Best of the Best and Checks and Balances
The unbundled approach to retirement plans allows a “best of the best” approach. The plan custodian, TPA, financial advisor, and ERISA attorney can be selected by the plan sponsor as an all star lineup of some of the best and brightest in the industry. With the bundled provider approach, the plan sponsor is saddled with what the provider has to offer. In the unbundled approach, the plan sponsor can quickly remove a provider that they are unhappy with. In the bundled provider approach, the plan sponsor is stuck if they are unhappy with a fact of the bundled provider’s work. In addition, selecting independent plan providers usually offers a system of checks and balances to make sure all providers are on the ball and using one, bundled provider won’t allow a check and balance because they can’t credibly watch themselves.

The Choice is Based on the Plan Sponsor’s Needs
A retirement plan with no compliance or plan design issues may find the bundled provider approach a better fit and any choice of providers regardless of the approach should be abused on the plan sponsor’s needs and size. There is no absolute best provider out there; it’s all about finding the right fit.

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