Don’t Fall For These 401(k) Plan Provider Gimmicks

By Ary Rosenbaum, Esq.

A “sales gimmick” is a term that refers to a method a business employs to immediately generate demand for its product or service. I just bought Fan Fest tickets 6 months in advance because they were giving me a $30 merchandise credit. Buying tickets or clothing on a gimmick is fine, it’s your money. Yet if it concerns your 401(k) plan and third-party administration (TPA) services, your fiduciary responsibility precludes you, from falling for it.

Free services for some time

There is no bigger marketing gimmick than offering free services for a certain period. I 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 its 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, plan 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, a 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 in their fee going forward.

Huge discounts

Similar to free services offered by TPAs are huge discounts, this is just another gimmick. A tech credit or a huge price cut to entice hiring a TPA is the same. It’s not a reason to hire a specific TPA. Like with many other sales gimmicks, the credits may not be automatic, and firing a TPA after the credit is over because they’re not very good isn’t easy because it’s time-consuming to replace them. Giving a break on pricing is enticing, but that’s not a reason to hire a TPA. You hire a TPA because they’re going to be great at what they do, not because they’re marketing like a used car salesman or offering bonker advertising like the old Crazy Eddie electronics stores (that was a Metro New York thing and stock fraud). You need to exercise your fiduciary duty, prudently, falling for some tech credit or bonker pricing, isn’t the way.

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, free insurance policies mean 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 Wrath of Khan, 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 to any business because of an article I wrote. The only problem was that he never referred me to any work, so I didn't lose anything from it. A fiduciary warranty is like lightning insurance, the chances that you will be covered as a plan sponsor are 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. I also noticed that some plan providers are offering audit protection warranties, which are similar in vein to fiduciary warranties. The chances of a government audit are slim, and the chances a warranty will cost a TPA to compensate plan sponsors is slimmer/

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 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 means nothing 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 functions that put plan sponsors at risk. While payroll provider TPAs will say I'm biased, I am because it's based on 22 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).

Beware of preferred Providers.

Some payroll providers don't want to be in a TPA business, some other service providers don't want the headaches either. So they may develop partnerships with TPAs. There is nothing wrong with co-ventures and preferred partnerships on the face of it. However, if a service provider is pushing me to a specific TPA, I want to know if they're being compensated. Referrals that are paid referrals aren't honest referrals and referrals should always be above board. If a TPA is offering a payroll provider a gift card or $100 a lead, that's something as a plan sponsor, that I want to know. When I refer plan providers to plan sponsors, I'm not being "greased." When I started my practice in 2010, I knew plan providers who offered me financial incentives to push referrals to them. I refused, my recommendations aren't for sale, even when one provider started comping me some wonderful Mets tickets. If you're being pushed to a specific TPA by a service provider, find out if they're being compensated for that push./

Focus less on gimmicks and more on competence.

You need to focus on the competency of plan providers, the services they offer, and the value they provide. Concentrating just on how much a provider charges or gimmick offers may cost you more in the long run if that provider provides incompetent services. I have seen too many plan sponsors forced into the IRS or Department of Labor (DOL) correction programs to fix the errors of plan providers that were picked solely on cost. This is not to suggest that low-cost providers are incompetent, it just means that the selection of a plan provider requires a careful process of evaluating them to find the best fit.

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