Issues with Hiring a Mutual Fund Company as Your 401(k) TPA

By Ary Rosenbaum, Esq.

In England, British breweries own many of the top beer pubs because watering holes are an effective means of beer distribution. If a business can control the method of distribution of their own products, they can expand the distribution while saving a couple of shekels by avoid having to pay a third party to distribute. The problem with producers controlling their own method of distribution is that it can lead to abuse. That is why in 1948, the Supreme Court of the United States in an anti-trust case forced the motion picture studios to divest their holdings in movie theaters because specific theater chains showed only the films produced by the studio that owned them. In the 401(k) retirement plan space, the top mutual fund companies and insurance companies offered bundled retirement plan services where they serve as the plan's custodian, third party administrator, and top choice of plan investments. Bundled 401(k) services offered by a mutual fund company or insurance company can be a great fit for some plans, but not all, and there are some issues that retirement plan sponsors should consider when considering a bundled TPA.

It's all about distribution.

The 401(k) industry is dominated by mutual funds, so it should come as no shock that many mutual funds companies and insurance companies (who have their own mutual funds) offer services as a TPA because it's an effective means of distributing their mutual funds. Mutual funds distribution is extremely important for mutual fund companies because their bread and butter are the funds' asset management fees and more assets under management equal more revenue for the mutual fund company. By going into the TPA business, these mutual fund companies and insurance companies could further increase the distribution of their funds. It's like why Pepsi owned Taco Bell, Pizza Hut, and Kentucky Fried Chicken because it was an effective means of getting their soda products into the hands of fast food patrons. Even though Pepsi spun those fast food restaurants into its own company, Pepsi still has lifetime contracts with them for soda.

While many mutual funds companies only offer TPA services for larger plans, there are a few mutual funds companies that have been rather aggressive in offering TPA services to small and medium size plans. They can be so aggressive in their pursuit of small to medium sized plans that they steal business from independent TPAs who offer their services on that same mutual fund company's trading platform. So they end up stealing business from a TPA that they had supported the TPA in getting in the first place. That doesn't help them when it comes time to maintaining a relationship with those TPAs.

They are not free.

While mutual fund companies do offer an attractive alternative as part of a

one stop shop, plan sponsors are under misimpression that the mutual fund companies' TPA services are free or close to free. As I have stated before, there is no such thing as a free lunch or free 401(k) administration. Mutual fund companies make their money as a TPA through those very same mutual fund management fees that I had discussed earlier. Many of the same companies that offer TPA services are the very same mutual funds companies that offer revenue sharing or sub TA fees to independent TPAs from the management fees they charge for plans that use their funds. So by keeping plans under their roof, these mutual funds companies can keep their revenue sharing/ sub-TA fees to themselves. These mutual fund companies also guarantee the fees they make, by suggesting that a percentage of a plan's assets (up to 100%) be invested into their own proprietary mutual funds. There is nothing wrong with using the proprietary funds form a mutual fund or an insurance company, but recent ERISA litigation should give plan sponsors some concern.

The problem with focusing too much on proprietary funds.

For plan sponsors and trustees who serve as fiduciaries under ERISA, it is a question of whether it is prudent to offer investments using a specific mutual fund company, only because that the mutual fund company is the TPA. The duty of prudence is something a plan sponsor as a plan fiduciary must exercise without any issue. I have seen too many plan sponsors load up on too many proprietary funds including one that used all 12 of their investment options using one mutual fund company regardless of the actual investment option and that's a problem because there is no mutual fund company that is the to performer in every asset class and style. Recent ERISA litigation has suggested that selecting plan investment just because they pay revenue sharing may violate a plan fiduciary's duty of prudence, it isn't a big logical leap to suggest that selecting an investment just because they are managed by the TPA will also land the fiduciary in hot water.

While some mutual fund companies have sterling reputations, there are a still a number of mutual fund companies who have been tainted by the late trading scandals of the last decade, as well as poor performance and high fees. All plan sponsors that utilize a mutual fund company as a TPA should understand that there is a cost involved with their plan's administration (check those disclosure forms), as well as being advised as to the standing of the mutual fund company within the entire mutual fund industry to make sure it doesn't become the next Steadman fund family. Too many plan sponsors that use a mutual fund company as their TPA don't have a financial advisor and that's a recipe for disaster as they wouldn't have an educated voice that tells that loading up on the TPA's proprietary funds isn't the best idea.

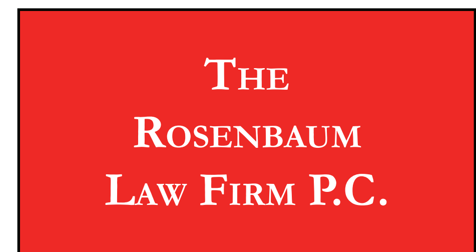
Plan sponsors should consult with their 401(k) financial advisor to determine whether a mutual fund company as a TPA is the right fit for them. Mutual fund companies may be an attractive option for some, but plan that offer what is known as out of the box provisions may not be a good fit, as well as a plan sponsor that wants unbundled options in the selection of mutual funds.

They are not like payroll provider TPAs.

While I have been highly critical of payroll providers serving as TPAs, that same criticism is not applicable to mutual fund companies. The reason why I don't have the same disdain for mutual fund companies and insurance companies as TPAs, they have an actual history of doing a credible job as a TPA for the clients they service.

Make sure it's the right fit.

Above all, plan sponsors should make sure that utilizing a mutual fund company or insurance company, as the bundled TPA is the right choice. That is determined on the plan's size, the cost of plan administration, and the plan's design sophistication. Plan design sophistication can be an issue because many of these bundled TPAs have a tough time with intricate plan designs that augment a plan's ability to maximize employer contributions. So a plan sponsors has a lot to consider whether utilizing mutual funds companies and insurance companies as a bundled provider TPA rather than just using their proprietary funds in an unbundled TPA setting.



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