Don't Hire ADP Or Paychex As Your 401(k)'s TPA

By Ary Rosenbaum, Esq.

If you're thinking about hiring one of the two biggest national payroll providers as your 401(k) plan's third-party administrator (TPA) think again. As an ERISA attorney with 25 years of experience fixing the errors made by ADP or Paychex in their roles as TPA, it's not something I'd recommend.

Payroll has very little to do with 401(k) plans.

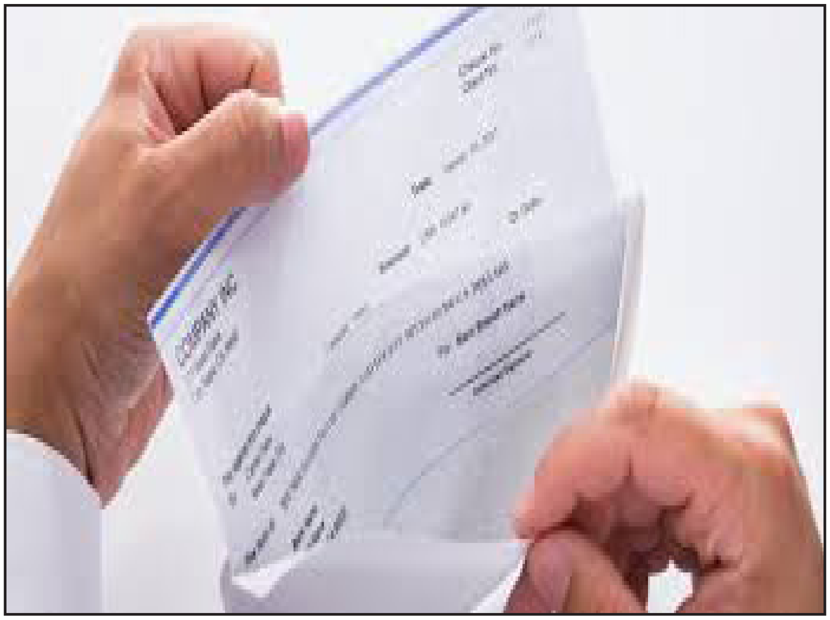
If a salesman from ADP or Paychex is trying to tell you how much easier it is to have them also serve as TPA in addition to doing your payroll, don't fall for the sales pitch. 401(k) plan administration has very little to do with payroll. Other than salary deferrals and compensation, 401(k) plan administration almost has absolutely nothing to do with payroll. The payroll issues that plague 401(k) plans are based on bad payroll data and that has absolutely nothing to do with having a payroll provider as the TPA. The payroll provider salesman will also tell you that the "360" integration of your payroll services with TPA services is very important since it would be seamless since they would be serving as the payroll provider and TPA. If it's so important, why do these payroll providers offer integration of their payroll services to competing TPAs? Coca-Cola isn't sharing its secret recipe with Pepsi, but ADP and Paychex offer payroll integration with their competitor TPAs because payroll is their business. While some of the larger mutual fund companies are in the TPA business, their errors are fewer and far between, when compared to ADP and Paychex.

TPAs are about competent plan administration and the two largest payroll providers aren't

ADP and Paychex have a lot of 401(k) plans to administer as a TPA because most plan sponsors don't understand what a TPA does. Popularity doesn't mean they're competent and based on my experience, these payroll providers aren't good at plan administration and haven't gotten any better. Payroll providers are popular because plan sponsors think they're getting a bargain by using their payroll provider as a one-stop shop for payroll and retirement plan administration. The problem is that retirement plans must abide by highly technical rules set forth by the Internal Revenue Code and ERISA. Your 401(k) plan is tested for participation and contributions to avoid discriminating in favor of highly compensated employees. You also have reporting requirements such as the annual Form 5500 and Form 1099 for plan distributions to participants. You must have up-to-date plan documents and the plan must be administered according to the plan document's terms. Also, if your plan is a participant-directed 401(k) plan, there are deposits made from payroll to the plan's trust through electronic transfer (or by check) as well as daily trades of mutual funds or exchange-traded funds. After the trades are made, assets must be distributed to participant accounts, which also must be updated with any gains, losses, dividends, and/or capital gains. Since your plan has so many moving parts, you need to find competent TPAs who are competent in plan administration. Errors in the administration of your plan can lead to the imposition of penalties resulting from an audit by the Internal Revenue Service or by the Department of Labor. The problem is that with any TPA errors, you are ultimately on the hook. This is why you need to carefully select a TPA, as opposed to just choosing your payroll provider because it looks good on paper.

You get little support from a payroll provider TPA

The deduction of 401(k) salary deferrals from payroll is just a small part of plan administration and while errors in the processing of payroll for salary deferral contributions can and do occur, such errors have become far less common since payroll has been computerized and automated. Unlike payroll, plan discrimination testing is not automated. While plan discrimination testing does require computerized payroll reports, it is heavily dependent on data collected from you. After the end of the plan year, the TPA will send a data request form to you. The data request form will ask for the census of all of your employees, their dates of hire, their dates of birth, hours of service, and, for employees who have separated from service, their dates of termination. The data request form will also ask you to specify the ownership of your company, whether you are affiliated with any other entities (through ownership or affiliated service), and to identify your officers. Since plan administration is so dependent on the information provided by you in the data request form, the information in that form must be correct for the discrimination testing to be accurate. Since many of the questions asked on a data request form can be highly technical, a good TPA will work closely with you to ensure that the data provided is accurate. Payroll providers, on the other hand, routinely expect plan sponsors like you to independently, and without any support or guidance, complete a data request form. The problem is that if you provide inaccurate information on the data request form, the payroll provider TPA will run the test using the faulty data and obtain faulty testing results. It's what I call: garbage in, garbage out and you can't afford their compliance test results to be garbage. ADP and Paychex play the Sgt. Schultz (from Hogan's Heroes) game when things go wrong: "They see nothing, they hear nothing, and they know nothing." Their contracts are well drafted and they won't be at fault for anything, they are the Teflon TPAs because nothing sticks to them.



You can never talk to just one person

Most TPAs offer plan sponsors a dedicated administrative representative that a plan sponsor can directly talk to, to get information. For ADP and Paychex, it seems only their larger plans get a dedicated representative, they offer the team approach to the smaller plans. From my experience, it is very difficult to track someone who physically worked on that plan. It's far easier to work with one plan contact than multiple contacts because the team approach leads to a lot of dropped balls. You can't afford any dropped balls.

They tend to offer plain vanilla plans and that can cost you a lot of money

ADP and Paychex tend to be unsophisticated in plan design, as well as not being proactive when a 401(k) plan has testing issues. One major component for you to set up a retirement plan is to maximize retirement plan savings for your plan participants. This can be done through a proper choice among many different plan types and plan designs. ADP and Paychex tend to only administer straight vanilla 401(k) plans, so they won't likely discuss the merits of new comparability or cash balance plans. I have had clients who would fail their discrimination tests for years before being approached by their payroll provider TPA to add a safe harbor contribution to avoid testing. I once reviewed an employer who was forced by one of the payroll provider TPAs to set up a second 401(k) plan because they couldn't handle a 401(k) plan with existing brokerage accounts, so this employer was forced to create a new plan, merge the assets from the old one into the new one, and file two Form 5500s for two plans (even though the payroll provider disclaimed any responsibility for filing a 5500 for the first plan which is now delinquent). While I understand that payroll provider TPAs now handle new comparability plan designs, they won't handle any administration or discussion of combination plan design with a defined benefit plan or cash balance plan. So that means if you want a cash balance or defined benefit plan coupled with a 401(k) plan, you have to hire another TPA.

They may offer fund lineups, but payroll provider TPAs aren't fiduciaries and they don't give investment advice

Too many plan sponsors that utilize the payroll provider TPAs don't have a financial advisor, which is dangerous for any 401(k) plan that is participant-directed. While ADP and Paychex are more than willing to offer a choice of investment options on their mutual fund menus, they aren't fiduciaries, so they aren't liable for any losses suffered by plan participants. They aren't responsible for picking mutual funds that pay a lot of revenue sharing back to them. While a financial representative from a payroll provider TPA may suggest what investments to select, they aren't considered to be giving investment advice, they aren't a fiduciary, and so they aren't legally culpable for their fund lineup suggestions. This leaves the plan sponsor and the other fiduciaries exposed to liability and holding the bag. Another interesting bit is that the reason that payroll provider TPAs get so much business is that they will refer plans to financial advisors who don't have one in the hopes that they can get referral business back from these advisors.

The turnover rate for the payroll provider TPAs is high

Many financial advisors who are critical of payroll provider TPAs maintain that a payroll provider TPA's salesperson is only concerned with a sale. That's because that is all they're paid for and, since the turnover rate for their TPA salespeople is high, they're less likely to be around when their plan sponsor clients have problems with plan administration. ADP and Paychex have been successful in the TPA business and they will gladly tell potential clients that they're the tops in the amount of plans they administer. ADP and Paychex also do well with plan sponsor surveys because most plan sponsors don't know the issues with their plan until after problems are discovered. While payroll provider TPAs have many clients, they have a high churn rate, which means that they gain as many plans as they lose. Good TPAs have very little turnover, suggesting that their clients stay with them because satisfied clients rarely leave.

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