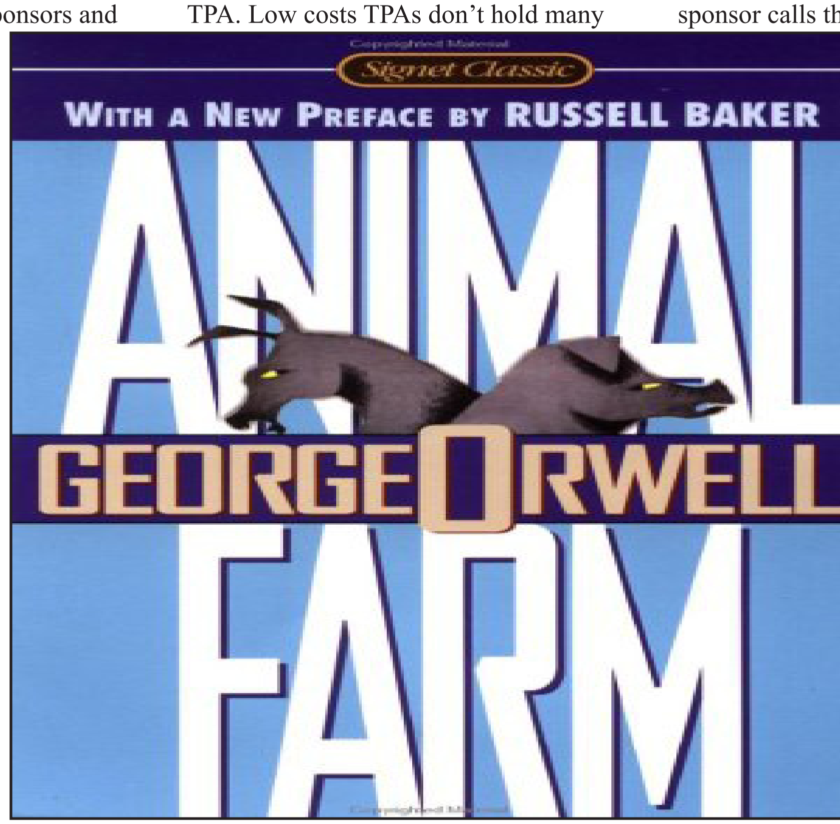
A 401(k) Financial Advisor Shouldn't Refer a TPA Just Because They're Cheap

By Ary Rosenbaum, Esq.

Animal Farm by George Orwell was a clever allegory of the Bolshevik Revolution and the Soviet Union where the oppressed animals overthrew Farmer Mr. Jones, only to start oppressing each other. A similar situation is when I find retirement plan financial advisors who are so sensitive about the fees they charge because of their concern about low cost advisors start recommending low cost third party administrators (TPAs) that underperform for the plan sponsors and themselves. So this article is about why retirement plan financial advisors should avoid recommending a TPA just because they charge low fees.



Fees are all about reasonableness

Thanks to retirement plan litigation and fee disclosure regulations, there is a lot of focus on fees. The biggest misconception out there about plan provider fees is that plan sponsors have to pick the lowest cost plan providers. Plan sponsors only have a fiduciary responsibility to pay reasonable plan expenses, not the lowest costs. Fees can only be determined to be reasonable based on the services provided. So if a plan sponsors wants to hire a plan provider such as a TPA who offers more "bells and whistles" than a low costs TPA, they can. Retirement plan sponsors have a fiduciary duty to pay reasonable plan expenses, but they also have a duty to hire competent plan providers. So a plan sponsor needs to document how they hired and reviewed plan provider and just saying you picked up a TPA just because they were the lowest bidder, that's not a good idea.

Low can mean low frills and more work

There is a reason why some TPAs charge low fees and that's because they offer a low frills service. They can't afford the same type of service that the providers who charge more. The problem is that most plan sponsors don't have the background to properly administer their plan, so they need some hand holding by their TPA. Low costs TPAs don't hold many hands and they require the plan sponsors to do much of lifting the load. Proper plan administration is highly technical and is above the head of most plan sponsors so a TPA that doesn't offer some form of white glove treatment in helping plan sponsors file out census reports and the reconciliation of plan records is going to cause more trouble than necessary. The problem by recommending a low frills TPA is that the retirement plan financial advisor who made the recommendation will end up lifting the load because when you recommend a TPA that doesn't hold up the end of their bargain, you end up the one who is going to catch the "ball" before it drops. A retirement plan financial advisor is not just a financial advisor; it often acts as the plan's ombudsman. So if the TPA is causing some issue, the plan sponsors are not going to call the TPA. The plan sponsor calls the financial advisor who recommends the TPA who is dropping the ball. A financial advisor has enough on their plate that they don't need to pick up the slack of a TPA who just offers too little in actual service. Well it serves the financial advisor right for making a bad referral.

Cheap TPAs rarely know the art of plan design

For the good TPAs that aren't just low-cost, one of their great selling points is their sophistication in what I call the "Art of Plan Design." A good TPA will not only handle the administration and recordkeeping of the plans that their clients delegate to them, they can also design retirement plan programs that can maximize employer contributions to highly compensated employees (which includes the owners), which maximizes tax deductions. Maximizing tax deductions puts more money in the financial advisor's clients' pocket through retirement savings (thereby assets under management) and less money in the pocket of government. There are too many cheap TPAs who don't understand plan design, which may makes life for them easy, but leaves money on the table for their clients. Retirement savings don't have to be built on 401(k) salary deferrals alone. There are enough tricks (all legal) that can help maximize savings through increased contributions to highly compensated employees. That maybe a safe harbor 401(k), new comparability/ cross tested design, a floor-offset arrangement, a cash balance or defined benefit plan, and a non-qualified plan to name a few as plan design options. One of the great plan design features is designing a 401(k) plan in combination with a defined benefit plan or cash balance plan. It's a known fact that the two largest payroll companies that are in the TPA business can't offer that; many other TPAs can't do it on their own either. Failure to offer that plan design to the plan sponsors that can afford puts less money in the pocket of employees and more money in the pocket of government. So financial advisors should work with a TPA that understands the rules concerning plan design because there is a lot of creative thinking that can help maximize employer contributions and tax savings for your client.

Financial advisors can't lean on cheap TPAs for help

There are many good TPAs willing to help a financial advisor out with their current clients as well as offering the assistance when they are currently prospecting for clients. I know that having worked with one of the greatest 401(k) salesman that ever was, the late Richard Laurita. Rich may not have understood a thing about retirement plans, but he knew when to assist the advisor he was working with during the sales process. I cut my teeth in 401(k) sales and client development by getting on many phone calls and going on many prospective client meetings with Rich and the advisor he was trying to cultivate business with. In addition, there are good TPAs with lots of good marketing materials that financial advisors could use with their prospective clients. Cheap TPAs can't afford to provide help to financial advisors because they can't afford to hire the staff that could help financial advisors properly market their services, a good TPA can afford to provide a financial advisor that extra free help that cheap TPAs cant. Financial advisors shouldn't be shy, there are quite a few quality TPAs that can provide them with help for client development and retention, all they have to do is ask.

A cheap TPA shouldn't be picked just because they refer them business

One of the dirtiest little secrets in the TPA business is that payroll provider TPAs generate so much business because they get referrals from financial advisors. These referrals are not because of their excellent work like most TPAs get referrals for. These referrals come with strings attached because payroll provider TPAs refer plans to financial advisors. Like slipping the maître d' a $20 bill, these payroll provider TPAs pay to play to get plans on their books. A TPA should always be picked based on a plan sponsor's need, not because the advisor got a nice referral. I have had financial advisors admit to this practice and then switch the plans they got referrals for away from these payroll provider TPAs because they know how bad the service is. Is that a way to do business? I don't think so.

A bad TPA referral could get the advisor fired

In the nearly sixteen years in the 401(k) plan business, I can tell you what the number one reason why financial advisors get fired from a plan. It's not because they failed to show up once in awhile or because they neglected to draft an investment policy statement. It's because they referred a bad TPA that caused the plan advisor headaches and the plan sponsor much grief. A financial advisor should make referrals to quality TPAs, not ones because they are just cheap. A good TPA referral will make a financial advisor's life easier and a bad one could get them whacked.

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