Hiring A 401(k) Plan Provider? Avoid These Mistakes

By Ary Rosenbaum, Esq.

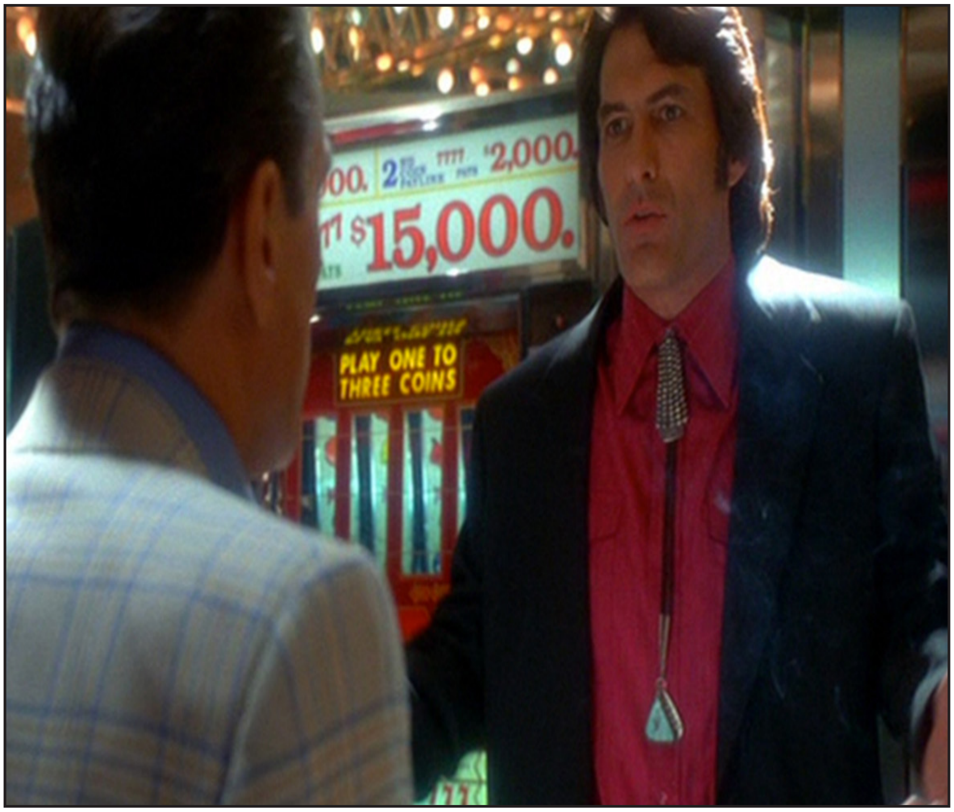
Many years ago when I was a young ERISA attorney working for a third-party administration (TPA) firm, I left to take a job as an attorney for a union-side law firm. That was a mistake because I joined the union-side law firm just to get away from the job at the TPA. Every decision you make for just the right reasons and as a 401(k) plan sponsor, changing TPAs must be for the right reasons, and often, plan sponsors make a change for the wrong reasons. This article is all about the pitfalls in selecting a new plan provider.

Make sure there is a reason for the move

Changing plan providers isn't like changing your clothes. While the shirt/blouse may not match the pants or shoes, it's a fashion faux pas that you can deal with for the day. When it comes to changing plan providers, you're not doing it very often and you need to make sure it's a perfect fit. Before changing plan providers, you need to make sure there is an actual reason for changing one or multiple plan providers. Change for the sake of change may make sense in firing a longtime Major-League manager that isn't connecting to his players, but that theory doesn't work in the retirement plan setting. You are a plan sponsor and a plan fiduciary and that requires the highest duty of care in law and equity. Any decision must be grounded in rational thought, otherwise, you will be indicated as having breached your fiduciary duty of prudence. You have a duty of prudence in hiring competent plan providers and you have a duty of only paying reasonable plan expenses. When it comes to cost, all you need to show is that you're paying reasonable costs for the services provided. You don't have to pick the cheapest plan provider, which is a mistake that many plan sponsors make because they don't understand that expenses only have to be reasonable and have to correlate with the services provided. That means that you have leeway in paying more for a plan provider that is providing you more in services. The only way to determine whether the fees that you're paying are reasonable for the services provided is by benchmarking those fees against what other providers charge. That can be done by shopping the plan around or by using a benchmarking service. One of the biggest mistakes that plan sponsors make is by shopping around the plan and comparing their plan provider and the services they provide to another provider that charges less, but also provides less in services. When it comes to benchmarking fees and providers, you need to compare apples to apples, not apples to oranges. The most important thing about the plan providers you use is whether they're competent at what they do. When it comes to plan administration by using a TPA and fiduciary services by your advisor, there is a lot of delegation to them and a lot of dependence on them doing a good job. Most errors when it comes to a plan (other than late salary deferral deposits) are usually caused by plan providers. If your plan provider is causing just too many errors, they are subjecting you to unwanted fiduciary liability. If an advisor fails to have you follow the terms of your investment policy statement or your TPA makes an error in your compliance test, you are going to be the one that bears the brunt of the cost and liability of these errors. Cost and competence are the major reasons why you're going to replace your plan providers. Any decision to replace a provider has to be prudent and you need to avoid the landmines that other plan sponsors step on by replacing a plan provider. So make sure you have a reason for a change and that change makes sense.

Make sure you're getting the same level of services and liability protection

Car shopping is one of those stressful points in my life and it probably explains why I haven't bought a new car in almost 9 years. The thing about car buying is that you know the difference between a Lexus and a Toyota, even if they are made by the same car company. You can tell the difference because Lexus is a luxury brand and Toyota isn't. A car buyer replacing their Lexus with a Toyota know that they're sacrificing luxury for the price. The problem with shopping for plan providers is that most plan sponsors replacing plan providers maybe hiring a provider that is offering less liability protection and they have no idea. For example, there are financial advisors that offer different degrees of fiduciary services. An ERISA §3(38) investment advisor controls the fiduciary process of the plan and all of the liability that goes with it. An ERISA §3(21) investment advisor doesn't assume all of the liability of the fiduciary process. Replacing an ERISA §3(38) fiduciary with an ERISA §3(21) means you would have less fiduciary protection. The same can be said about hiring a new TPA to replace the current one and realizing unfortunately later that the new TPA does a whole lot less for them and that the plan sponsor has to do a whole lot more. How many plan sponsors replace their good TPA with one of the two top payroll providers as their TPA and learn to regret it? If you're being met with proposals on replacing your plan providers, make sure that not only the cost is similar, but more importantly, that the level of service is similar. If you're trading down, hopefully, you'll know that, and there should be a trade down in fees.



New chief wants their own team

Often, when there is a change on top of a business, change is inevitable. One of those changes can be a change of plan providers. The problem with this situation is that the change is for the sake of change and the desire of this new leader to make an imprint. If there is no prudent reason for replacing a plan provider, this is a bad idea. I often find in these situations is that the new "chief" at the company (or just the main decisionmaker of the plan) wants to hire someone they know. Sometimes it's done to reward a plan provider that they worked with before, sometimes it's to reward a plan provider who is a friend or a relative. Sometimes, it's even more nefarious than that. When I worked for a TPA, a longtime client fired their longtime financial advisor. Shortly thereafter, the longtime advisor was rehired. It seems the plan contact there was fired after disclosing that the new Chief Financial Officer (CFO) hired a new advisor who was a buddy and who happened to kick back a portion of the few to the new CFO. I'm not suggesting any new plan decisionmaker just want to get a kickback from a provider or hire a friend or relative, I've just seen too many times when this change is made and it's not for the benefit of the plan sponsor.

Don't hire a plan provider just because they were juiced in

When I worked as an associate at a semi-prestigious law firm (sorry Lois), I was approached by an insurance salesman to talk about the "benefit" I was being provided by the firm. I don't know how this insurance salesman got in his hook with the law firm and which partner "juiced" him in, but he was a swarmy guy whose life insurance quotes were almost double what I could get on the open market. Too often, 401(k) plan sponsors select a plan provider just because they're "juiced In" through a relationship with one of the decision-makers or are associates with a trade group. You should hire a new plan provider for a variety of reasons such as cost and competence. You shouldn't hire a plan provider just because they're a sponsor of your trade association. I had a client that I had to talk them out of hiring a plan provider that was offering a more expensive service with gimmicks and less liability protection, and the only reason that they almost hired them was that this insurance-based plan provider was a big sponsor of their trade association. There are many reasons to hire a plan provider, someone being "juiced" in isn't one of them.

Have an independent review

Before you make the change of plan providers, I think getting a second opinion from an independent viewpoint makes complete sense. Hiring an independent ERISA consultant or an ERISA attorney like yours truly goes a long way in making sure that a plan provider change actually makes sense.

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