What 401(k) Plan Providers Never Tell Plan Sponsors

By Ary Rosenbaum, Esq.

I have a college degree and two law degrees (I'm not bragging), so I have three alma maters. I attended Stony Brook University, American University Washington College of Law, and Boston University. Out of the three, my favorite will always be Stony Brook University. It is the only public university out of the three and I always envisioned it as the "State University of New York Center that Could", it's gone from the fourth-best to the best university center since I went there. The Stony Brook Seawolves even made the NCAA Men's Basketball Tournament and the College World Series. The reason that Stony Brook is my favorite is because I always felt the school never made any promises that it couldn't deliver, it never tried to be something that it's not, and they never tried to hide anything derogatory about them. The biggest disappointments in my life have always been with situations where something such as a school an organization or a job was billed to be something bigger and better than it was. When it comes to retirement plan provider(s), there are quite a few things where they aren't likely to be forthcoming. This article is about what plan providers may neglect to tell their plan sponsor clients.

Plan sponsors are on the hook for liability.

When you hire a lawyer or an accountant to perform their services, they are essentially on the hook if something goes wrong (malpractice). While plan sponsors can certainly sue incompetent plan providers, the problem is that the plan sponsor is still on the hook for liability. For example, if the third-party administrator (TPA) fails to properly conduct the compliance testing of a 401(k) plan and is caught in an Internal Revenue Service audit, it's the plan sponsor that is going to have to pay the penalties. If the TPA doesn't file Form 5500, the plan sponsor is going to have to pay for the penalties. When the financial advisor never shows up but collects a fee without doing their work, it's the plan sponsor's fault for hiring them. A plan sponsor is also a plan fiduciary and being a fiduciary requires the highest duty of care in equity and law. So trying to pin the blame on an incompetent plan provider will minimize the liability exposure, but it's the plan sponsor that is always on the hook. When a plan sponsor hires an ERISA §3(16) administrator or an ERISA §3(38) fiduciary where the plan provider assumes the liability of day-to-day plan administration (§3(16)) or discretionary control over plan investments (§3(38)), the plan sponsor is still on the hook for hiring them. So a plan sponsor will always be on the hook for liability on what the plan provider does. I don't fault plan providers for not bringing up this subject that often because when it comes to selling products and services, being negative doesn't work well.

The Plan Provider's Churn Rate

I always use the term "churn rate", yet many people don't know what that is. A churn rate is a measure of the number of individuals or businesses moving out of a collective group over a specific period. It is one of two primary factors that determine the steady-state level of customers that a business will support. So a churn rate for a TPA or a financial advisor is the number of plan sponsors that terminate the plan provider's services over some time. For example, the largest TPAs are also the largest payroll providers. While these payroll provider TPA's cite their client base, I believe that they have a higher churn rate than those TPA's where plan administration is the focal point of their business model. While plan providers love to specify how many plans they handle

and how many assets they have under management, a better metric of their effectiveness as a plan provider is the churn rate or the average length of retention by their plan sponsor clients. Again, getting fired by a plan sponsor isn't something that a plan provider would like to acknowledge, but the churn rate or the average length of retention is a better effective metric of a plan provider's competence than just the number of clients they have or assets under management.

Training and Background of Day-to-Day Contacts

Every plan provider will tout the educational background and experience of their management team. Unless the management team is expected to handle the plan sponsor's plan on a day-to-day basis, that doesn't mean much especially if the day-to-day contacts have no background or training in the retirement plan business. I worked for two TPA's and most of the administrators that I worked with weren't very good and quite honestly, it had nothing to do with years of experience because I worked with many experienced administrators who weren't very good. If the Chief Executive Officer went to Harvard and has 25+ years of experience, that's swell. Yet that 25 years of experience and Harvard education means nothing if the employees who handle the plans don't have the requisite knowledge or expertise to properly operate as a retirement plan provider. A good retirement plan provider will have well-seasoned employees working for them and constant training because retirement plan laws and regulations change over time. A retirement plan provider that is forthcoming about how well-seasoned their employees are is probably a better fit than the providers that keep mum on the subject.

Conflicts of interest

The retirement plan industry is full of conflicts of interest. There are quite a few plan providers that have a conflict of interest that they don't feel the need to disclose to their plan provider clients. It can be something as simple as a plan provider making a referral to another provider for insurance. There are many TPAs with questionable relations with the auditors hired by plan sponsors to review the work of the TPA. Most plan providers have no conflicts of interest while those that do aren't transparent despite the need to be.

When it's time to say goodbye

They often say that: "You're hired to be fired." I think it means that no matter what you do, every relationship will have its conclusion. Any relationship that a plan sponsor will have with their plan provider will eventually end. The problem is that no plan provider will acknowledge that their relationship with any client will eventually come to an end. That's why many providers out there aren't very transparent when it comes to the termination of their services. Many TPAs out there don't specify how much it will cost to de-convert a retirement plan from their system. Many plan providers who sell annuity or insurance-based contracts don't like to be transparent about any surrender charges that a plan sponsor and their participants may have to suffer if they terminate the agreement with the plan provider before the contract is up. Since plan providers are less than forthcoming when it comes to terminating their services, it's incumbent for the plan sponsor and their counsel to review any termination costs and the process of saying goodbye to a plan provider.

Whether they are properly insured

While a plan sponsor is on the hook for the liability of running their retirement plan, an incompetent plan provider will still have to answer for their incompetence. Yet most retirement plan providers aren't very transparent on whether they are properly insured against errors and omissions that they cause. Since mentioning errors and omissions in insurance policies is considered negative in discussion, plan sponsors need to make sure that their providers are properly insured. Otherwise, plan sponsors will be holding the bag.

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