PRECISION

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Things You Might Not Know About Your Retirement Plan

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Weakest Link … What's Yours?

By Richard N. Carpenter

Education matters. Experience matters. Having a good TPA matters. Why is it that many professionals in our industry don't seem to think there is a difference between having someone just out of high school with only two years of experience administer their plan versus a professional with advanced degrees, professional designations and decades of experience?

Most people are unaware of the requirements to become a TPA. A while back an old friend called and asked that exact question. He started the call with, "this might be a stupid question, but I didn't know who else to call." Not a bit flattered at being designated as his go-to guy for stupid questions, I waited for his question. He explained that he should probably know the answer and asked "what does it take to become a TPA?" There are no requirements, I explained … zero, zilch, nada.

DID YOU KNOW?

… "what does it take to become a TPA?" There are no requirements, I explained … zero, zilch, nada. The qualification for becoming a TPA is merely the desire of an individual to proclaim they are one.

A good TPA provides accurate, proactive, professional service at a reasonable price. A bad TPA provides the opposite. A chain is no stronger than its weakest link, and this truism applies to organizations. Prudent advisors and fiduciaries invest countless hours meticulously designing, selecting and monitoring every aspect of their retirement plans or those of their clients…except the administration. There is a tendency among advisors, especially those relatively new to the business, to treat the administration as a commodity, assuming that all the operations are substantially the same. The reality is that nothing could be further from the truth; I have worked with more than 90% of the TPAs in the US, and I can assure you that there is a vast chasm among firms.

When I ask advisors about the most important criteria they use when recommending or selecting a TPA, the overwhelming response is "someone that won't foul up my client relationship." Talk about a low bar! It doesn't have to be this way. There are great firms that provide exceptional service and value; in most cases, it does not cost any more to hire the best.

There is essentially the same number of 401(k) plans today as there was five years ago. As a result, the TPA business has become increasingly competitive. An obvious way to be more competitive is to lower fees. After all, who doesn't like a bargain? However, anyone with fiduciary responsibilities should investigate the reasons for price disparities between vendors. In the TPA community, the most common way to charge less is to do less. The second most common method is to hire less experienced people. Sometimes they do both.

When advisors and sponsors are confronted with this logic, the most common response is "we have never had a problem." My retort: How do you know? Plan sponsors and advisors are often ill-equipped to analyze all of the intricacies of plan compliance and administration. When plans are reviewed the "we never had a problem" explanation evaporates. Earlier this year the Employee Benefit Security Administration (the division of the Department of

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Labor that oversees employee benefit plans) issued a report, stating that 4 in 10 audits performed by Independent Qualified Public Accountants had major deficiencies. The EBSA reviews about 3,000 plans per year, so the chances of a plan being randomly selected are less than 1:200, or a little less than having your personal tax return audited. The DOL, in general, and the EBSA, more specifically, have instituted staffing initiatives to increase the number of auditors. The EBSA has found that 75% of the plans it audits contain an ERISA violation of some sort.

Consider the following nightmarish scenario: you have referred a 100-life plan to a discount TPA, saving them $300 in annual administrative fees. The discount TPA shaves their fees by providing fewer services, performed by less-qualified individuals, and they do not invest in their infrastructure. In this case, they cut corners on their IT systems. The TPA's IT system is hacked and the identities of all 100 participants are stolen.

The plan sponsor is not happy; the participants are not happy; and their attorneys are rabid. They want answers in addition to retribution, so you get an invitation to provide a deposition and the 300 bucks in savings seems foolish.

Attorney:

What was your criterion for recommending the discount TPA?

Advisor:

TPAs are a commodity, so I recommend the cheapest one.

Attorney:

Were you aware that the TPA you recommended did not maintain errors and omissions insurance?

Advisor:

No, I have been referring business to them for years, and I never had a problem. They sometimes refer business to me, so it has been a very good relationship.

Attorney:

Were you aware that my client's participant data maintained by the discount TPA is worth over $5,000 to identity thieves?

Advisor:

No.

Attorney:

Did you ever ask the discount TPA what steps they had taken to protect my client's information?

Advisor:

No.

Attorney:

Let me get this straight. You knew or should have known the TPA did not maintain E&O insurance, had taken virtually no steps to protect my client's sensitive data, and performed no criminal background checks on their employees …

The deposition devolves into an interrogation and goes on for over an hour. Your decision to refer this TPA is the worst decision you have made since joining a Wild Turkey chugging contest while you were in college; this hangover will last a lot longer.

It is human nature to become complacent when things are going well. History is replete with examples of smart people underestimating risk. The refrain "we have never had a problem" is but one symptom of complacency. Complacency was running rampant in the South Florida housing market in the late 80s. On August 22, 1992 the complacency evaporated when Category 5 Hurricane Andrew destroyed 63,000 homes and severely damaged over 100,000 others…in one county.

In the aftermath, it became evident that much of the devastation could have been prevented. A grand jury report found that "suffering was aggravated by the systemic failure and the building regulation process" and "we have foolishly been dependent on the building industry to police itself."

Recognizing that the qualification for becoming a TPA is merely the desire of an individual to proclaim they are one, the American Society of Pension Professionals and Actuaries ("ASPPA") proactively started addressing the issue of firm qualifications. They assembled a task force of some of the best minds in the industry and came up with 84 best practices for TPAs and recordkeepers. The voluntary certification process conducted in partnership with the Centre For Fiduciary Excellence, or CEFEX, insures that certified firms are following these best practices.

At a minimum, before you recommend or engage a TPA, you should ask the following questions:

1. Have their operations and controls been reviewed by an outside party such as CEFEX, or do they have an SSAE 16 audit?
2. Do they have E&O insurance and what are the limits? Have they had any claims?
3. What is their quality control process? Surprisingly, many TPAs have virtually none.
4. What steps have they taken to protect the plan's valuable personal data?
5. What are the qualifications of the person or team working on your plan, and what is their caseload?

There are many other things you should know about your TPA partner. Complacently relying on the observation that "we have never had a problem" is not the way to perform your professional due diligence.

Additional Reading

CEFEX Standards of Practice For Retirement Plan Service Providers

https://www.cefex.org/downloads/ASPPA_Standard_of_Practice_v1.6.pdf

Richard Carpenter is the President and founder of USVI Pensions and Consulting, primarily focused on preparing TPA firms for mergers and acquisitions. Prior to starting USVI Pensions and after concluding his tenure as the senior manager for Deloitte & Touche's Florida employee benefits practice, Richard established and ran the Technical Answer Group, Inc. (TAGdata.com) for 10 years before selling it to Wolters Kluwer Law and Business who continues to operate it to this day.