TPAs as the Vanguard of Participant Outcomes

Firms that embrace systematic approaches to increasing coverage and participation will enjoy more growth and strategic partnership opportunities.

BY JACOB T. LINNEY

Third party administrators are at the vanguard of assisting employers in designing 401(k) plans that improve the probability that a participant will achieve a successful retirement outcome.

TPAs also provide important guidance on how various plan design strategies that impact retirement outcomes will affect plan administration responsibilities for both the employer and their covered service provider.

The key to achieving the plan's objectives of better outcomes is ensuring that a TPA has plan design expertise. Traditional administration firms that embrace systematic approaches to increasing coverage and participation will have more growth and strategic partnership opportunities than their competitors.

COVERAGE AND PARTICIPATION

The importance of plan design in improving outcomes cannot be overstated. For TPAs that have this skill set, the future is bright, especially in light of the glaring statistics that reveal how badly plan sponsors are underserved when it comes to effective plan design to improve participant outcomes. For example:

- Only about 50% of employees have access to employer sponsored retirement plans.[1]
- Of those that offer a retirement plan, the Department of Labor suggests that only 70% of the employees participate; and of those participating, 85% were automatically enrolled.[2]
- Of employers with fewer than 500 employees, only 12%

1 *EBRI Databook on Employee Benefits*, available at www.ebri.org/publications/books/?fa=databook.
2 "Automatic Enrollment 401(k) Plans for Small Businesses," available at www.dol.gov\ebsa\publications\automaticenrollment401kplans.html.

FIG. 1: U.S. EMPLOYEES BY EMPLOYER SIZE

Employer Size (EEs)	Number of Firms	Number of EEs	Percentage of all EEs
1-9	4,661,829	12,964,342	10.7%
10-19	633,141	8,497,391	7.0%
20-99	526,307	20,684,691	17.1%
100-499	90,386	17,547,567	14.5%
500 or more	18,469	61,029,560	50.7%
Total	5,930,132	120,903,551	

Source: Statistics About Business Size (Including Small Business) From the US Census Bureau, "Employment Size of Employer and Nonemployer Forms, 2008," at www.censs.gov/econ/smallbus.html.

FIG. 2: EMPLOYEE COVERAGE AND PARTICIPATION RATES BY EMPLOYER SIZE

Employer Size (EEs)	Offered a DC Plan	Participate in a DC Plan	Take-up Rate
Less than 10	24%	17%	71%
10-24	36%	24%	68%
25-49	48%	34%	70%
50-99	59%	41%	70%
More than 100	71%	53%	74%
Total	60%	44%	73%

Source: "Assessment of Retirement Plan Coverage by Firm Size, Using W-2 Tax Records," Irena Dushi, Howard M. Iams and Jules Lichtenstein. Social Security Bulletin, Vol. 71, No. 2, 2011, at www.ssa.gov/policy.

have implemented automatic enrollment.[3]

THE OPPORTUNITY FOR AUTOMATIC ENROLLMENT

Clearly, there is much work to do in educating employers about the benefits of auto features — as can be seen in Fig. 1 and Fig. 2. Of course, this assumes there is an interest on the part of the employer to improve retirement outcomes for all eligible participants.

The conclusions drawn from Figs. 1 and 2 include:

- 29% to 74% of employers do not offer a retirement plan.
- Approximately 56% of the work force does not participate in a defined contribution plan.
- Of the 44% currently participating in a retirement plan, 85% are automatically enrolled.
- Of remaining employees, there are 50 million employees[4] waiting to be enrolled in a plan.

This represents an unprecedented opportunity for skilled TPAs to add quantifiable improvements in participation, deferrals and outcomes by applying proven plan design strategies.

AUTO FEATURES INCREASE PARTICIPATION, DEFERRALS, OUTCOMES AND WORKLOAD

There is significantly more administrative work required to support a plan using automatic enrollment. This is a primary reason why so many plans have yet to adopt the strategy. Unfortunately, few small employers are equipped with the resources to support auto features. Therefore, if this feature is going to become more popular in small plans, advisors, record keepers and especially TPAs will need to provide additional services to position an employer to correctly execute the automatic features in the plan. In fact, of the three likely candidates to fill in the service gap, TPAs are in the best position to take on the extra work involved with a plan that adopts automatic enrollment.

FILLING THE SERVICE GAP WHEN AUTO FEATURES ARE ADDED

In the traditional TPA model, TPAs receive census data at the end of each plan year to run a series of compliance tests, prepare administrative reports and complete a Form 5500 for the employer to sign.

3 "Automatic Enrollment, Employee Compensation, and Retirement Security," Barbara Butrica and Nadia Karamcheva, Center for Retirement Research at Boston College.
4 120,903,551 total employees X (1-44% that are offered a DC plan) X 85% that accept auto-enrollment = 57,550,090 employees.

When an automatic enrollment feature has been added, however, this model needs to change. In particular, if the employer does not have the resources to align payroll with plan entry dates tied to an auto enrollment feature, the employer will need to submit payroll records each pay period to the TPA to ensure that all automatic features are being processed properly in each payroll. Though this creates more work for the TPA, receiving payroll files each pay period may create efficiencies with other administrative tasks. Of course, the challenge with this approach is coordinating a smooth and timely delivery of payroll data to the TPA.

THE NEXT STEP: RETAINING YOUR TPA TO A FIDUCIARY ROLE

For process-challenged employers, appointing the TPA as a "named fiduciary," *i.e.*, as either the plan administrator or an appointee of the plan administrator, to assume certain responsibilities of the plan administrator can be an attractive option. If TPAs are involved with the day-to-day operations of the plan, should they go so far as to enroll employees, interpret plan documents and take on discretionary control of the administration of the plan? In others words, should a TPA that becomes this involved in the automatic enrollment administration be a 3(16) fiduciary? Let's take a look at the arguments pro and con.

'The TPA Should Be a 3(16) Fiduciary' Argument

The reason for a TPA to be involved in the day-to-day work of the plan is so the employer does not have to. When the TPA is a fiduciary, it takes discretionary control over the operation and administration of the plan, with very little involvement from the employer.

In fact, when a TPA is handling all of the administrative tasks involved with automatic enrollment, all the employer needs to do is update their payroll for the correct deferral rates, send a payroll report to the TPA and send money to the record keeper. If the TPA and record keeper can integrate data feeds with the payroll provider, then all the employer needs to do is send the money.

'The TPA Should Not Be a 3(16) Fiduciary' Argument

Just because the TPA is involved in day-to-day operations does not mean that the TPA should be responsible for the day-to-day operations of the plan. The employer should still retain that responsibility.

In fact, even if the TPA is a fiduciary, the employer will still be responsible for selecting, monitoring and reviewing the fiduciary TPA. It is better for both the TPA and the employer if the employer continues to have the authority and discretionary control over the operations and administration of the plan. Additionally, giving an outside party discretion and control of the plan may reduce overall plan oversight, increasing the possibility of fraud by the third party. This is especially true if the TPA has information and access to the employer's bank accounts.

Thus, processes should be put in place to ensure that the employer is approving the TPA's administration and to retain the ability to interpret plan documents.

COST

Many employers want someone to administer their retirement plan, but will they pay for the extra work?

TPA and record keeping prices have been squeezed for years. Employers have never been more cost-sensitive, and revenue sharing is on its way out. When I first started working for a TPA, nobody was talking about offsetting administration costs with revenue sharing. Now it is a conversation that many TPAs are having.

The flaw in this thinking is evaluating cost without the value added for the additional cost. There is no denying that employers are skeptical of paying for anything where the value for them is unclear. The challenge for the TPA is to:

- explain how the extra work leads directly to better participant outcomes;
- put costs into context so it is easy for the employer to understand what they are getting and what they are paying; and
- keep it simple.

Additionally, many advisors are involved in the selection of TPAs. The TPA must also explain their value from the advisor's point of view. Sharing the responsibility for creating participant outcomes with advisors is a valuable service that leads to a better advisor practice.

CONCLUSION

Automatic enrollment combined with auto-escalation provisions work — they get more employees to participate in 401(k) plans, and they get those who participate to increase their savings. However, only 12% of employers with fewer than 500 employees have automatic features in their plan. This creates an opportunity for TPA firms to get involved with automatic features to drive participant outcomes.

Administration firms that develop valuable services around plan designs that drive participant outcomes will be in a better position to partner with advisors, and in a better position to grow compared with their competitors.

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