



Solving the Mystery of TPA Revenue Sharing Arrangements

A look at the pricing strategies that TPA firms employ today to take advantage of revenue sharing payments.

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Revenue sharing arrangements between record keepers and third party administrators have been in place since the daily valuation movement first gained popularity. These arrangements were initially intended as a financial resource for TPA firms to maintain reasonable fee structures while managing advances in technology and training requirements.

As record keepers established new partnerships in the TPA channel, the monetary value of these arrangements increased rapidly. What once was intended as a supplemental budget for training became a lucrative incentive. Many TPAs treated revenue sharing as a financial bonus in exchange for promoting the services of the record keeper to financial advisors and plan sponsors. This is one of many

reasons 408(b)(2) fee disclosure was promulgated.

ERISA SECTION 408(b)(2): FEE DISCLOSURE

Under ERISA, plan fiduciaries are required to act in a prudent manner when overseeing the implementation and operation of an ERISA-covered employee benefit plan. Regulations published by the Department of Labor in 2012 require a plan fiduciary to ensure that fees being paid to service providers are “reasonable” based on the scope of services being provided. Prior to the regulations, plan fiduciaries were not always provided with a clear understanding of the fees being deducted from the plan. Therefore, effective July 1, 2012, service providers are required to disclose the fees being assessed and paid from plan assets (for

the most part except for some nuances with bundled providers).

TPAs’ PRICING STRATEGIES

TPAs must disclose their fees just like any other service provider; however, most TPAs receive an initial installation revenue credit as well as an ongoing administration revenue credit from record keeping partners known as “revenue sharing.” Today, there are a number of pricing strategies that TPA firms employ because revenue sharing payments allow them that flexibility. The three most common strategies are:

- The TPA offsets billed fees with 100% of the revenue sharing they receive from the record keeper for

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- both setup and ongoing, dollar-for-dollar.
- The TPA only offsets the initial setup fees while collecting the ongoing revenue sharing from the record keeper *in addition to* collecting billed annual administration fees from the plan sponsor.
 - The TPA prices their services at a “lower” fee and bills a fixed fee to the plan sponsor *in addition to* collecting the full revenue sharing payment from the record keeper.

Unless the TPA revenue sharing payments are disclosed, the plan fiduciary typically has no way of knowing how much a TPA is receiving in revenue sharing. Therefore, any TPA pricing strategy other than 100% of revenue sharing offset makes it very difficult for a plan fiduciary to meet their 408(b)(2) obligation of ensuring that fees paid to a TPA are reasonable for the level of service they provide.

ILLUSTRATING THE IMPACT OF TPA REVENUE SHARING ARRANGEMENTS

Some financial advisors believe that because TPAs offer low, fixed, billable fee structures (without providing any offset using revenue sharing), they are able to meet the plan’s fiduciary disclosure requirements to comply with 408(b)(2). They also

feel that this is the most economical model for plan sponsors.

Let’s look at an example to see if this is truly the case:

- Assume the plan has \$1,900,000 in assets.
- There are 20 participants with an account balance.
- XYZ record keeper provides revenue sharing to qualified TPA partners at 30 basis points upon setup (\$5,700 for this example) and 5 basis points annual (\$950 for this example).

Revenue Collected by a ‘Low-cost’ TPA Firm

- \$500 setup fee billed to the plan sponsor; TPA keeps \$5,700 revenue sharing from the record keeper
- \$750 ongoing fee billed to the plan sponsor; TPA keeps \$950 revenue sharing from the record keeper

The “low-cost” TPA firm collects \$6,650 from the record keeper in the first year *while billing the plan sponsor an additional \$1,250*. The total first-year revenue collected by the “low-cost” TPA is \$7,900.



Now let’s take a look at the fees assessed by a consultative TPA, which offsets billed fees dollar-for-dollar with revenue sharing received from the record keeper:

Revenue Collected by a Consultative TPA

- \$2,400 setup and revenue sharing offset 100% dollar-for-dollar
- \$2,100 ongoing and revenue sharing offset 100% dollar-for-dollar



The consultative TPA requires \$4,500 in first-year revenue. The record keeper pays the consultative TPA \$5,700, which the TPA fully offsets so there is *no billed setup fee to the plan sponsor* and there is actually an *excess of*

\$1,200. That \$1,200 can be applied to the annual billed fee along with \$950 annual revenue credits, making the cost to the plan sponsor zero in the first year of the plan. In some cases (depending on the specifications of the plan), the total credits exceed the TPA’s required revenue so any excess credits received can be placed into the ERISA account for the sponsor to use towards additional plan expenses.

The consultative TPA only collects the revenue required to administer the plan, where the “low cost” TPA collects all available revenue sharing and bills the plan sponsor additional fees. This exercise is a valuable demonstration that allows you to position the services of a consultative TPA for the same — or often less — cost to your client.

WHAT TYPE OF TPA FIRM DO YOU WANT TO RECOMMEND TO YOUR CLIENTS?

Your clients trust you to make recommendations to service providers on their behalf. In doing so, it is essential that you understand the revenue sharing arrangements for these service providers, which will reveal the true cost of administration. Ask your service providers to:

- quantify the revenue needed to perform their administration and compliance services
- disclose any revenue sharing arrangements they receive
- outline the services they provide

This will help you choose your strategic partners and make confident recommendations, knowing they are in the best interest of your client. **PC**

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