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Subject: **BENCHMARKING ADVISOR FEES & SERVICES:**

### **A LEGAL PERSPECTIVE BY FRED REISH**

The new 408(b)(2) mandated disclosures highlight the DOL's long-standing position that plan fiduciaries have a legal duty to prudently select and monitor their service providers. Sponsors also have **a fiduciary duty to document reasonableness.**

The request for proposal (RFP) and benchmarking are the most commonly accepted ways to evaluate service providers. The RFP is certainly the preferred path for determining the quality of services offered, particularly when teamed with benchmarking, but it is time consuming and expensive. As a result, **most evaluation will be done through benchmarking and some of it will be challenged in court.**

In addition to the cost, range and quality of services, the advisor's qualifications determine the value. **When the advisor and/or team lack the necessary qualifications, the cost and range of services is irrelevant.** Unfortunately, the quality of services is difficult if not impossible to measure through benchmarking.

In addition to cost, quality and range of services, Fred Reish notes that "ERISA requires fiduciary evaluations to consider the *relevant* factors." In other words, **the database must be statistically valid, consider plan assets, participants and fees charged to plans of similar size when ascertaining the reasonableness of advisor compensation.**

Beyond the database, the range of services offered by the advisor must be evaluated. For example, advisors offering a broader range of services can not only justify higher compensation, but offer more value as well. On the other hand, advisors offering their services at a lower fee could be expensive if their range of services is limited.

The quality of services also plays a role and this is where evaluation gets complicated. Measuring the quality of services is certainly a difficult proposition. Nevertheless, Reish believes **it can be measured in a legally meaningful way by using considerations beyond assets, different benchmarks and other methods for establishing peer groups.**

Fred Reish's exclusive CFDD '12 keynote on *Benchmarking Advisor Fees & Services From A Legal Perspective* will pioneer new ground by discussing the criteria for category measurement. If embraced, **the new approach could change the industry.** It could also **help retirement plan specialists differentiate and demonstrate their value.**

In addition to the Reish session, the CFDD '12 agenda contains six other blockbuster keynotes, including *DC Plan Investment Trends: Death Of The Style Box* by Neel Kashkari, Managing Director and Head of Global Equities at PIMCO. Sponsored by Allianz Global Investors, the well received Shlomo Benartiz & Glenn Dial will return with a new presentation, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans*.

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### JUSTIFYING THE VALUE PROPOSITION

The CFDD's 12/27/2011 newsletter, *The Impact Of Disclosure On Consolidation*, discussed how the DOL's new disclosure requirements would increase exposure and client attrition for some advisors while others would benefit. The newsletter also discussed the impact of unintended consequences.

The new disclosure regulations were designed to reduce costs to plan participants. Assuming they don't cause participants to opt out of their plans, drive them to higher cost retail investments and trigger small plan terminations, the regulations could conceivably lower participant costs. At the same time, they will significantly increase the burden and costs to plan sponsors and the trade. **As the higher cost of disclosure is passed on, it could eventually eliminate potential savings and result in higher costs to participants.** On a collective basis, the trade does not have the margins to absorb the new disclosure costs.

Because the new 408(b)(2) disclosures require providers to list the services they offer, registered reps offering model portfolios, plan level participant advice or participant level investment advice may find themselves constrained by new home office policies designed to preclude fiduciary status. **When fiduciary limitations are imposed by the umbrella organization, commission-based advisors will have to justify or redefine their value proposition to remain competitive.**

The new disclosure requirements will alert plan sponsors of any limitations imposed on their advisors and some will no doubt be surprised to learn that they will no longer be receiving fiduciary type services. In addition to defending their value proposition, **non-fiduciary advisors will have to recommend an outsourced fiduciary solution to plan sponsors who want plan or participant level advice** as part of their services.

Mesirow, Wilshire, Morningstar and others have all stepped up to the demand and this has created a cottage industry for outsourced fiduciary services. This approach could be widely embraced in the small plan market because in addition to providing a fiduciary solution for competitive purposes, it may allow the advisor to cross sell - including rollovers - without running afoul of the DOL. A fully outsourced 3(38) service may also allow the advisor to collect commissions on the funds offered at the plan level. Providers and recordkeepers seeking to avoid fiduciary status could find a menu of these services equally appealing.

Outsourced fiduciary services are, however, unlikely to make much difference in the mid to large plan market because accomplished advisors serving those market segments already offer these services. More importantly, **the holistic approach offered by true retirement plan specialists provides value far beyond investment consulting.** This inherent value is the real differentiator above the small plan market.

To enhance their value proposition, **all advisors, including non-fiduciary advisors, should consider assisting plan sponsors with their duty to evaluate and act upon the new disclosure requirements.** Advisors will find it difficult to benchmark and determine the reasonableness of their own offering, but they can add value by assisting sponsors with the items below.

- Educate Plan Sponsors About Their Responsibilities
- Establish Procedures To Manage The Disclosure Process
- Request Additional Information When Disclosure Is Not Provided Or Incomplete
- Benchmark & Determine The Reasonableness Of Covered Service Providers
- Identify, Evaluate & Manage Conflicts
- Suggest New Service Providers When Appropriate
- Report Service Providers Who Fail To Comply
- Document The Entire Process In A Fee Policy Statement
- Manage The New Service Provider Evaluation/Selection Process
- Evaluate & Recommend How Fees Should Be Allocated To Participant Accounts
- Develop Proactive Fee Related Participant Communications

In addition to offering major value, **managing the disclosure process and providing guidance on the prudent application of fees to participant accounts could result in new business lines offered on a stand-alone basis.** While repackaging work for future applications is smart in any market, increased volume, scalability and efficiency are particularly important in mature markets.

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## **ALLOCATING FEES TO PARTICIPANT ACCOUNTS**

The looming participant disclosure regulations require annual disclosure of the level and category of administrative expenses - including revenue sharing - as well as the quarterly fees charged to plan participants. Without these disclosures, sponsors could be denied 404(c) protection for investment losses.

The increased disclosure will place the allocation of participant account fees under a microscope. In addition to increased fee awareness and the need for more participant education, **sponsors are becoming more concerned about the less than equitable distribution of revenue sharing.**

Given that administrative costs are driven by the participant count rather than the investment markets, the more equitable per-capita approach to calculating administrative fees has become somewhat prominent in the large plan market. Indeed, when administrative costs are based on assets and paid via revenue sharing, participants with large account balances may pay much more for the same services. Revenue sharing also varies by investment option, i.e., participants investing in company stock, low cost index funds and/or a brokerage account may not pay their fair share or anything for that matter towards administrative costs.

Ignoring reconciliation and recordkeeping capabilities, the per-capita approach is somewhat simple. Nevertheless, when revenue sharing is replaced with a per-capita charge, participants with small balances could be discouraged from participating even though they may be paying less than the invisible fee offset through revenue sharing.

The elimination of funds with revenue sharing is another option and it is preferred by the top advisors in the CFDD's network. When institutional share classes are offered with no revenue sharing, the expenses are deducted from each participant's account on a pro rata basis. The sponsor could also elect to pay the additional costs. On the other hand, small plan sponsors may not be willing to pay the administrative costs or pass on the higher visible costs to participants.

Other options are also available, but regardless of the approach, **the fee allocation methodology must be prudent and teamed with an effective and proactive communication strategy.** Given the lack of DOL guidance, fee litigation, inconclusive court cases and the disagreement among prominent ERISA attorneys, advisors should be very cautious about advising sponsors on the allocation of excess revenue sharing.

The aforementioned observation is quite important because in addition to being the elephant in the room, **advising on fee allocation is clearly a legal issue and a looming source of future litigation.** Marcia Wagner (Managing Director, The Wagner Law Group) noted in a prior CFDD release that the advisory community hijacked the ERISA Law Industry and she was right. Advisors taking liberties to draw legal conclusions from BrightScope reports with intent to intimidate plan sponsors into making changes have recently been reported to state bar associations and accused of the unauthorized practice of law.

Given our goal of helping advisors grow revenue, mitigate risk, increase efficiency and participate in consolidation, sessions on *How To Prudently Allocate Participant Fees* and *Managing Disclosure As A Business Line* have been added to the CFDD's 2012 Advisor Conference agenda.

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### THE IMPACT OF HOLISTIC SERVICES ON CONSOLIDATION

As noted many times in recent publications, **retirement plan advisors will not be able to participate in consolidation above the small plan market without the ability to influence positive outcomes, reduce risk through good governance, differentiate with a more holistic business model and proactive compliance solutions.**

The term holistic remains difficult to define, but it is generally viewed as *total* plan consulting. As noted by Pat Oberlander (Executive Director, Corporate Retirement Plan Services, UBS Financial), holistic services generally include: plan design, provider search & selection, IPS development, investment selection & monitoring, fiduciary education, fee benchmarking, participant education, advice solutions, defining goals and monitoring success.

Jon Chambers (Principal, Schultz Collins Lawson Chambers, Inc) notes that higher level services could include operational compliance reviews, correction calculations, income determinations, VCP submissions and other services beyond the average advisor's practice.

Pete Swisher (Sr. Institutional Consultant, Unified Trust Company) further notes that: **"The old model of advisor as fund-picker is a dead end vulnerable to fee compression and a core service that is easily automated at the vendor level."**

These services are obviously differentiating and while the top advisors offer sub-sets of these services to their large plan clients, observers question whether or not the marketplace will support the fees required to provide these services.

The holistic approach is not economically viable in the small plan market, but **large plans are no longer satisfied with traditional consulting services.** No matter how well the services are provided, investment reporting, fund selection and conducting vendor searches are now perceived as a commodity.

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As noted by Don Stone (Managing Partner & CIO, Plan Sponsor Advisors), “The aforementioned services are certainly building blocks, but they are not sufficient to build a successful retirement plans practice today. Today’s value is holistic and outcomes-based at both the plan and the participant level. Because many advisors are not trained or capable of providing these holistic services, **the demand will contribute to the consolidation of the advisory industry by the firms capable of providing them.**”

As previously noted by Jeff Gratton, (Managing Director, SageView Advisory Group), “**A holistic approach to plan level consulting has consistently proven that advisors can influence outcomes.**” **Nevertheless**, outcomes based consulting is not required by ERISA nor is it wanted by all plan sponsors. For those that do want the services, but aren’t willing to pay for them, advisors should be aware of the bundled vendors that support the delivery of this approach on a cost effective basis.

Given their complementary viewpoints, Don Stone (Managing Partner & CIO, Plan Sponsor Advisors) will join Jeff Gratton (Managing Director, SageView Advisory Group) as a co-presenter of the CFDD ’12 session on *A Holistic Approach To Retirement Plans Consulting: The Path To Consolidation*.

Going forward, advisors will increasingly be *prequalified* before they are allowed to participate in benchmarking and the RFP process. For an insider’s view of how this process works, Stone will also join the breakout session on *Evaluating & Vetting Retirement Plan Advisors: A Mock Committee Meeting*. Other panelists will include Bruce Ashton (Partner, Drinker Biddle & Reath, LLP) and Gary Sutherland (CEO, NAPLIA).

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### CFDD 2012 ADVISOR CONFERENCE

The CFDD’s October 22-24, 2012 Advisor Conference, *Outcomes Based Consulting, Higher Margin Business & Increased Efficiency*, is the premier education and networking event for the retirement plans advisory industry.

Hosted at the convenient downtown Chicago Swissotel, the two and one-half day, Monday-Wednesday conference offers **more VALUE, CONTENT, CONVENIENCE, ATTENDANCE and GROWTH SOLUTIONS** than any other event. Our advisor audience continues to expand and **over 1,200 retirement plan specialists will attend CFDD ’12**.

Known as the *King of Content*, the CFDD’s broad, diverse and bottom-up agenda remains at the top of the food chain. The *fifty* different breakout sessions are populated by the industry’s **most sought after speakers and accomplished advisors**.

Providing actionable takeaways, **prestigious research organizations** will also participate in the CFDD ’12 agenda, including Spectrem Group, Chatham Partners, LIMRA & Brightwork Partners.

The **seven blockbuster keynotes** include Fred Reish's exclusive and game changing presentation on *Benchmarking Advisor Fees From A Legal Perspective*. Other keynotes, including *DC Plan Investment Trends: Death Of The Style Box* by Neel Kashkari, Managing Director and Head of Global Equities at PIMCO. Sponsored by Allianz Global Investors, Shlomo Benartiz & Glenn Dial will return with a new presentation, *Save More Tomorrow: Practical Behavioral Finance Solutions to Improve 401(k) Plans*.

The fragile economic recovery and the investment markets remain challenging. With the retirement plans market and the financial services industry maturing, full compliance has become almost impossible. Competition has intensified, differentiation is increasingly difficult and margins are compressing. At the same time, clients are demanding more and tax code changes could have a major impact on the industry.

Given the changing dynamics, **advisors must increase their volume, improve efficiency through scalable solutions, diversify and develop higher margin business.** Because **advisors cannot participate in consolidation without influencing positive outcomes, differentiating with a more holistic approach and reducing risk through good governance,** CFDD '12 will provide the applicable deliverables.

In addition to the aforementioned, CFDD '12 will *Emphasize Investment Approaches With Pricing Power, Returns Beyond Performance, Model Portfolios, IAR Distribution Of Participant Elected Managed Accounts, ERISA Vs. Non-ERISA Fiduciary Standards, Who's Winning & Losing In The Nonprofit Markets, The Impact Of Tax Code Changes, Qualifying RIA/IARs Providing Participant Level Advice, Success Metrics and Behavioral Finance.*

Hiring, training, succession planning and scalability remain the biggest business challenges facing advisors. Practices can't grow without staffing and they can't be monetized without succession planning. To enrich their practice, **advisors may bring one immediate team member at a 50% discount.**

To add value and increase efficiency, the CFDD's Advisor Conference provides **a single source solution for unmatched core CE credits**, including IMCA, CFP, fi360, ASPPA, NIPA, IBF, CFA, SPARK, The American College, the College for Financial Planning and more. As an added bonus, **conference attendees can earn the Accredited Investment Fiduciary (AIF®) designation by attending fi360's discounted pre-conference training.**

Attendees further benefit from early registration discounts, a fiduciary insurance discount program, **a conference CD-ROM and online access to ALL prior year conference presentations, including the audio files of each presentation.** To access the 2011 conference presentations and MP3 audio files, go directly to: <http://www.thecfdd.com/CFDDconf2011presentations>.

In addition to **FREE wireless** in the guest rooms, the meeting rooms and the exhibit area, the hotel's **cell phone reception is excellent.** A **charging station** and **cyber café** are also available and spouses may attend the conference at NO additional cost.

**Complimentary food, beverages, snacks, cocktails and a NASCAR themed Kick-Off Party are all included in the registration fee.** Sponsored by Allianz Global Investors, Simulated **Racecar Gameplay Competition with meaningful cash prizes** is also included.

NASCAR will be the marketing theme and feature a TIAA-CREF sponsored **Primary Grand Prize Box Seat Package To The Daytona 500**, including beachfront accommodations. A **Secondary Grand Prize Package To The Charlotte ALL-Star May Race** will also be offered, including a hot pit pass (access to everything except the race car) and behind the wheel **Racing School Classes**. To qualify for the grand prizes and the cash prizes, registrants must stay at the conference venue, the downtown Chicago Swissotel.

Recognizing the urgency to act now, CFDD '12 will provide **UNBIASED guidance and exclusive GROWTH SOLUTIONS** to elevate your practice. For more information on the CFDD's 2012 Advisor Conference, go to the conference homepage at: <http://www.thecfdd.com/CFDDconference2012>. To register early, **SAVE MONEY**, find out what is working from your peers and benefit from business building takeaways, register online by going directly to: <http://www.regonline.com/Register/Checkin.aspx?EventID=1026462>.

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