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New Fee Disclosure Rules – Create Unintended Consequences

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In mature markets there is always downward pressure on pricing and the retirement plans market is no exception. However, with the advent of the new fee disclosure rules, advisors are particularly vulnerable to a heightened level of risk associated with their obligation to report fees and services. According to the new 408(b)(2) regulations, all covered service providers including advisors will be required to provide a responsible plan fiduciary, hereinafter referred to as the "plan sponsor," with a written description of their services rendered for compensation received by July 1, 2012. This requirement represents a nuisance for many that have fully divulged their fees and services in the past, but for many others, 408(b)(2) is a nuclear bomb with potentially dire consequences. How so? Consider the following three advisor scenarios:

- The Absentee Advisor – Compensation has been collected for years with little or no service being rendered. Will truthful admission of this fact pattern cause ERISA counsel to recommend a plan sponsor to pursue the advisor to recoup excessive and unreasonable fees paid in the past or future?

- The Over Promise and Under Deliver Advisor – This optimistic chap will deliver an embellished written description of services, some of which have never been delivered in the past and most likely will not be delivered in the future. Will ERISA counsel suggest that a fee paid for services not delivered is unreasonable? If so, will ERISA counsel recommend action necessary to recoup excessive and unreasonable fees paid in the past and/or in the future?

- The Insecure Advisor – This advisor hears the word benchmarking or 408(b)(2) and immediately reduces their fee, if they can, to meet a preconceived mental notion of reasonableness. Is this a knee-jerk reaction or prudent response to an excessive fee arrangement? Is it possible ERISA counsel would perceive an advisor's action to reduce fees as an admission of guilt and that fees have been excessive and unreasonable in the past? Will such a reaction encourage ERISA counsel to suggest the plan sponsor, in keeping with their fiduciary obligations under ERISA, seek a refund of some portion of past fees received? Bottom line, if the fiduciary fails to seek a refund, the fiduciary is personally liable for that portion of the fee that is excessive.

July 1st is fast approaching so advisors have little time to consider their options. However, if you are an advisor that falls into one of the three scenarios outlined, I have the following suggestions for your consideration:

1. Resign: In addition, help the plan sponsor secure the services of a qualified advisor before July 1, 2012 so that on that date a suitable replacement is in place that shoulders the liability and responsibility for communicating

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their compensation for services they will render.

2. Buy E&O: Before you do, confirm that it covers you for a prohibited transaction claim filed today for actions committed in the past.

3. Don't Embellish: Advisors by nature are optimistic and sales oriented so it is not unusual for advisors to over promise and under deliver. Unfortunately, for many advisors that succumb to this temptation, ERISA imposes a higher standard of ethical and moral behavior which requires truthful disclosure.

   Also, if you decide to upgrade the services you deliver, be sure to identify the new services separately. This will help you avoid a claim that new services not yet delivered were part of the services you offered in the past but failed to deliver. Offering new services may be appropriate in light of the new regulatory demands but you do not want the new services to be used by ERISA counsel as a club to support a claim of unreasonable and excessive fees collected in the past.

4. Collaborate with an Expert: Well-adjusted advisors know their level of expertise and weaknesses. Most advisors are stellar communicators and educators but lack the knowledge, experience and skills to deliver the level of fiduciary guidance that plan sponsors need. In fact, in many instances an advisor may be prohibited from offering fiduciary services by their broker-dealer or compliance officer. In such cases, the advisor still has an important role to play in the plan as the communications and education expert but needs to participate on a team that can offer holistic plan level fiduciary services. This is best accomplished by collaborating with a functional fiduciary advisor under ERISA § 3(21)(A)(ii), a discretionary investment manager under ERISA § 3(38) or a discretionary Trustee under ERISA § 403(a).

Advisors that do collaborate with other experts will typically participate as a solicitor. In other words, the ERISA §§ 3(21), 3(38) or 403(a) fiduciary will directly contract with the plan sponsor and the advisor will become an agent of the fiduciary or a subcontractor as that term is defined under 29 C.F.R. 2550.408b-2(c)(1)(viii)(F).

Advisors that operate as a solicitor may need to confirm their broker-dealer or compliance officer will approve and permit this business structure and the collection of fees from the fiduciary for services rendered by the solicitor advisor.

Also, advisors that operate in a solicitor role may find their business structure attacked by advisors that offer fiduciary services in a competitive situation. In such situations it is important to remember that not all fiduciaries are alike, especially those that leverage their skills to work with advisors as solicitors. Fiduciary advisors that develop a business model that includes a solicitor recognize their own limitations to serve plan sponsors from afar. To ensure they can keep a pulse on the client and to enable a smooth transition from the accumulation to the distribution phase for participants, a fiduciary needs the support of regional solicitors. A solicitor is not only providing communication and education services but also maintains the client relationship, operates as a trusted liaison between fiduciary and plan sponsor, filters complaints and is free to provide investment advice services to participants that are transitioning from active employment to a retired status.

CONCLUSION: If you are one of the three advisors described herein, take action now, don't delay. The unintended consequences of the new 408(b)(2) regulations come with significant costs. Advisors should give thoughtful consideration to communicating only those services in writing that they are capable of delivering. Advisors that claim expertise they do not have and cannot support are a train wreck waiting to happen.

Fiduciary Risk Assessment ("FRA") provides consulting, expert witness and qualified assessments of advisor expertise. PlanTools is a wholly owned technology subsidiary of FRA that delivers web-based expense analysis, benchmarking, 408(b)(2) reporting, revenue sharing database, standards-based performance risk assessments and fiduciary governance solutions. For more information about FRA/PlanTools contact David J Witz, AIF® at 704-564-0482 or dwitz@fraplantools.com

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