



## Ten Resolutions for Greater Prosperity in 'The Year of the Fiduciary'

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If you think selling and servicing 401(k) plans isn't easy today, ERISA is about to make it even harder. Its new fee disclosure requirements and its redefinition of ERISA fiduciary to include just about anyone who gives any kind of investment advice are going to create a litany of challenges for plan providers and advisors. Some recordkeepers and administrators may get out of the retirement business altogether, while others, particularly registered investment advisors, will have to take on the legal responsibilities of the ERISA fiduciary role, shedding the various 'fiduciary-lite' designations many assumed they held in the past.

The good news is that firms that can adjust to these challenges can use them to their competitive advantage. Here are ten steps your firm can take to prepare for The Year of the Fiduciary.

### **1. Understand what it means to be a fiduciary**

Really. Many people think they know what it means to be an ERISA fiduciary, but may not, while others have no idea at all. So let's start with basics. Anyone who advises a plan on its investments must follow ERISA's five fiduciary rules:

- Ensure that the portfolio offers an appropriate number of diversified investment options
- Make sure that costs are reasonable
- Evaluate, select and manage investment options in a prudent manager
- Follow plan documents, unless they conflict with ERISA regulations
- Always act in the best interests of the plan and its participants

If any of these provisions present a challenge to you or your organization, start thinking about how you may need to adapt.

### **2. Eliminate conflicts of interest**

If you receive a commission for selling investment products or services, you're not acting solely in the plan's best interests. While ERISA's proposals provide a loophole that allows



brokers and other commission-based advisors to act in a non-fiduciary capacity, the price of this evasion is that these brokers must explicitly acknowledge that these conflicts of interest prevent them from providing investment advice. This will not go over well with plan sponsors, many of whom consider investment advice and fiduciary assistance to be the most important considerations for selecting and sticking with plan providers. Brokers that want to stay in the business may need to establish separate RIA practices within their firms to accommodate these demands or risk losing business to fee-based RIAs who aren't saddled with conflicts.

### **3. Get ahead of the 'fee disclosure' game**

The days of 'hidden fees' are over. ERISA will soon require plan providers and investment companies to provide full disclosure of fees and expenses paid out of plan assets. Investment companies will have to provide detailed breakdowns of payments paid to plan administrators, including sub-TA fees, rebates and payouts from 12b-1 fees. Likewise, plan administrators will have to disclose any payments over \$1,000 paid to affiliated recordkeepers, trustees, lawyers, accountants and other service providers.

ERISA is giving plan providers and investment companies until July to get their fee-disclosure act together. Smart plan providers will begin disclosing these costs much earlier, first to existing clients and then to prospects. Disclosure should come in user-friendly formats that educate, rather than confuse, plan sponsors and participants. Forward-thinking providers will even provide comparison of each category of fees to industry averages for plans of similar sizes and asset levels.

### **4. Lower participants' investment expenses**

In this new era of cost-efficiency, plans that are loaded with A- and B- share class funds are going to be high-visibility targets for ERISA's scrutiny. In time when a diminishing number of actively managed funds consistently beat their benchmarks, there is no reason why participants should pay 5% or more in loads. Plans should increase no-load alternatives for new participants and freeze load funds to new investors, allowing existing shareholders to benefit from their lower investment management fees. Providers should also add or increase the number of index funds and lower-cost alternatives, such as common trust funds and ETFs.

### **5. Help plan sponsors develop an investment policy statement**

Many plans, particularly those in the small and microplan market, don't have investment policy statements (IPS). Without such a policy, plan sponsors have no established methodology for ensuring that their investment decisions are being made and evaluated prudently. Working with your clients to develop an IPS with clearly defined investment goals, as well as portfolio construction and performance evaluation parameters, will increase their appreciation of your 'fiduciary value.' You don't need to create an IPS; a



Google search will provide countless examples that you can modify for use with your clients.

## **6. Learn to live with the end of 12b-1 fees**

The SEC has finally put the kibosh on 12b-1 fees as we know them. No longer will they be used as glorified slush funds to enrich brokers and recordkeepers. The SEC will replace the 12b-1 with a generic 'marketing fee' that tops out at 25 basis points per year. For funds with both load and no-load share classes, the other 75 bps formerly considered 'servicing costs' can now only be assessed annually until its cumulative costs surpasses the maximum load of its most expensive share class. Huh? Simply put, a no-load share class with an A-class relation charging 5% up front can only charge 75 basis points for seven years, because at that point the cumulative charge of 5.25% would exceed the A-share's 5% load.

## **7. Lead with advice**

No longer do 401(k) plan sponsors care about having the top-performing funds in their plans, since the last few years have largely leveled the playing field. They're not as worried about meeting participation targets and passing compliance tests, since automated enrollment and ERISA's safe harbor provisions have largely eliminated these traditional worries. What plan sponsors want, more than anything else, is a plan provider who will help them understand and meet their fiduciary responsibilities and remain in compliance with ever-changing ERISA regulations. The promise of exceptional, proactive client service and education will win new startup plans and poach plans away from neglectful incumbents far more effectively than 5-star funds and glossy marketing materials.

Salespeople who can demonstrate their firm's ability to educate plan sponsors on these critical issues during the sales process have a far better chance of gaining and retaining clients than those who lead simply with 'product and performance.'

## **8. Get your fiduciary house in order**

ERISA has estimated that the costs of complying with its new standards may run to more than a million dollars per provider. Sales processes and presentations, marketing collateral, web sites, fee disclosures and service contracts will have to be reviewed and, if necessary, updated to meet ERISA's fiduciary guidelines.

Conversely, broker-dealers, recordkeepers, and other providers who don't wish to serve as plan fiduciaries will have to completely eliminate any language that implies they're providing investment advice from their marketing and operational materials. Moreover, they will have to include specific disclosure that states that they do not act in an advisory capacity.



## 9. If you can't be a fiduciary, partner with one

TPAs, recordkeepers, and other plan administrators that don't have the expertise or resources to serve as their client's ERISA fiduciary should partner with qualified registered investment advisors who are willing to take on this responsibility.

Partnering will likely end the common practice of providers positioning their 'recommended fund lineups' (usually based on the highest fee rebates) as investment advice. Instead, RIA-recommended lineups that may not offer as-attractive payouts will take their place. Since providers will need to fully disclose these costs anyway, however, this partnership will increase client satisfaction in the long run by demonstrating the commitment of the provider to provide the most cost-efficient options.

## 10. Be your clients' trusted retirement advisor

Plan sponsors value proactive client service more than anything else, which means going beyond annual testing and tax filing conversations and plan reviews to deliver education and advice. At least once a quarter, call your clients to identify their concerns and make them aware of new issues that may affect them. Supplement standardized communication with additional information on new ERISA initiatives. Even if your firm doesn't serve in a fiduciary capacity, demonstrating your commitment to helping your clients understand and address these complex and difficult challenges will increase your clients' trust and position your firm as something more than simply a provider of products and services.

### Changing for the better

As painful as these changes may be, and as difficult as it may be for some plan providers to remain profitable and competitive in this new era, it's important to remember that The Year of the Fiduciary is ERISA's response to pleas from both participants and plan sponsors to clean up decades' worth of hidden fees, questionable practices, and fiduciary slight-of-hand on the part of some plan providers and advisors.

In this new era of financial and corporate accountability, the pendulum is rightfully swinging toward plan sponsors and participants, where it should always have been. After all, in a time when most retirement portfolios have barely registered positive returns over the past ten years, anything the industry can do to ease plan sponsors' concerns is a step in the correct direction.

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