

May 11, 2011

## Fiduciary Corner

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In this issue of Fiduciary Corner, we will provide a review of the predominant business models being used by advisors in the retirement plan marketplace today. We will arm plan sponsors with the questions they should be asking their advisor in order to determine the model their advisor is using. Knowing the business model of their advisor is critical today for a Plan Sponsor due to the upcoming Fee Disclosure from Service providers to plan sponsors and disclosure being mandated by the Department of Labor to participants too.



### What's in a name?

Like many things in life, it was much simpler in the past. A stockbroker or broker sold products and earned a commission on the product. An advisor or consultant/planner provided advice for a fee. The financial industry has gone through an evolution, **brokers are now calling themselves any number of names including financial advisors or financial consultants** and this change of terminology makes it much more difficult for plan sponsors in determining the type of advisor you are dealing with.

There are two primary business models used by advisors in the retirement plan industry today:

1. **The first model is a commission-based model.** This model uses asset-based fees (12b-1 fees or insurance company wrap fees) built into the product to compensate brokers /advisors for selling and servicing retirement plans.
2. **The second is a fee-based model.** A specific agreement between the advisor and the plan sponsor outlines the services being performed and the fees associated with those services. This is normally reflective is working with a Registered Investment Advisor (RIA).

It is very important as a plan sponsor to understand the key differences in the two models in order to ensure that your objectives in hiring a third party to assist you can be accomplished. Let's examine a few of the key differences in the two structures and provide you with several questions and tools that are available to assist you in your research.

**Commission-Based Broker Model** – individuals working in this model are characterized by having Series 6 or Series 7 licenses and are under the jurisdiction of FINRA. FINRA is the self-governing body established by the industry to oversee broker activity. **Brokers with Series 6 or Series 7 licenses are held to a suitability standard.** Suitability basically means that the product being sold to the client must fit their situation not necessarily be in their best interest. Brokers using this model can also only work with products or providers (record keepers) that their Broker-Dealer has pre-negotiated selling agreements. Any broker who receives various compensation from the product cannot serve in a fiduciary capacity due to the potential for conflicts of interest.

**Fee-Based Advisor Model (Registered Investment Advisor- RIA)** – individuals working in this model are characterized as Registered Investment Advisors (RIAs) by having Series 65 or Series 66 licenses and are under the jurisdiction of the Securities and Exchange Commission (SEC). **Advisors (RIAs) working in this environment are held to a fiduciary standard at all times.** A fiduciary standard means that the interests of the client supersede all other interests. There are no product affiliations which mean that advisors working in this model are

free to recommend what is in the best interest of their client. Fees in this model can be either asset-based or flat fee but since the fees are not built into a product, there can be no conflicts of interest.

Many commission-based brokers and their broker-dealers have recognized the limitations of working in a purely commission environment and have developed a **hybrid model where they are dually licensed as both a broker and an advisor (RIA)**. This "wearing of two hats" can create confusion to sponsors. The two models are culturally different; broker model is mainly focused on the product while the RIA is focused on the client's best interest. A bigger issue is how do you know as a client when your advisor is wearing his "broker" hat and when he is wearing his "advisor (RIA)" hat?

Having an understanding of the structure of compensation paid to your advisor is going to be extremely important given the upcoming changes requiring the disclosure of fees to plan sponsors and eventually participants for the following reasons:

1. **Formalized Services Agreement** - Fee-based advisors (RIAs) have always provided clients with a separate formal agreement that outlines the scope of services to be performed, stating they are serving in a fiduciary role in the agreement and a schedule of fees for the services rendered. Commission-based advisors have not been required to disclose this information. The 408(b)(2) fee disclosure regulations effective January 2012 are designed to bring everyone into parity by mandating that anyone providing services to the plan have disclosure in writing.
2. **Benchmarking** - For the first time, all information regarding fees will be available to plan sponsors. As a fiduciary, the plan sponsor will be responsible for gathering the proper information and be proactive in understanding the fees being charged and determining if the fees are reasonable. Benchmarking the fees and services will be critical for Plan Sponsors/ Fiduciaries to ensure that fees they are paying are reasonable for services rendered.
3. **Advice vs. Recommendations** - Sponsors also need to consider how counsel provided by their advisor can and should be utilized. Fee-based advisors (RIAs), since they are compensated outside of any products, have the ability to provide unbiased advice to retirement plan committees and the advice can be relied upon as the basis for decisions made by the committee. Plan fiduciaries cannot rely on "recommendations" made by commission-based advisors due to potential conflicts of interest arising from the fact that they are being compensated by the product. If Plan Sponsors rely on a commission based advisor's recommendation the Plan Sponsor is making that decision and will be held accountable for that decision and any ramifications.

The following is a list of questions and sources to access additional information that is available to plan sponsors in order to perform due diligence on your existing advisor relationship or to determine the type of relationship you should expect to have in a new relationship.

- Do you (advisor) have a written agreement with your clients? If yes, does it outline the services being offered, fees for those services and whether you serve in a fiduciary capacity? If no, why don't you have a formal agreement?
- Do you (advisor) have a Series 6 or 7 license? If yes, they receive commissions.
- Do you (advisor) have a Series 65 or 66 license? If yes, they are an Investment Advisor Representative working for a Registered Investment Advisor (RIA).
- Do they (advisors) have both Series 6 or 7 and Series 65 or 66? If yes, they are dually registered and you want to ask why they "wear two hats"?
- Information on brokers and advisors is available at the Securities and Exchange Commission website at <http://www.sec.gov/investor/brokers.htm>

- The SEC has also developed a list of 10 questions called **Selecting And Monitoring Pension Consultants - Tips For Plan Fiduciaries.**

The new fiduciary world has arrived and the days of understanding how your advisor is being paid and what level of fiduciary responsibility is upon us.

Plan Sponsors are going to be held even more accountable for their fiduciary duty and must understand what role their advisor is playing for them. Is their advisor a broker who has sold them a plan/product (this has been the typical way plans have been handled in the past). If this is the case Plan Sponsors must recognize that the Plan Sponsors are the sole fiduciaries for the plan and fiduciary decisions being made.

Many Plan Sponsors are becoming aware of this changing fiduciary world and therefore the gravitation to a fee based advisor (RIA) is increasing, since RIA can be a fiduciary and fees are transparent.

Either model-commission based or fee based RIA are allowed but it is critical now more than ever for plan sponsors to understand the role their advisor can and will play in their plan. This Fiduciary Corner is written to provide you the information you need to determine these issues in an ever changing and complex fiduciary world.