Fee Disclosure: Opportunity or Threat for Plan Advisors?

By Editor Test *Wed, Oct 17, 2012*

DoL rules 403(b)(2) and 404(a)(5) are motivating plan sponsors to reevaluate their advisory relationships and, in many cases, send out requests for proposals. Plan advisors tend to either salivate or cringe at the implications.

Ever since the Department of Labor's two new fee disclosure rules went into effect last summer, plan sponsor advisors have been either bemoaning or celebrating the impact of the new rules on their business.

Excluding for the moment the possibility that many reasonable people can see this issue from both sides, let's say that a bright line exists between two groups of plan advisors:

- Those who worry that plan sponsors will become obsessed with reducing fees, even if it means sacrificing quality, and that sponsors will fire good plan advisors in favor of sweet-talking low-bidders.
- Those who can't wait to capture new business by demonstrating that a plan sponsor's existing advisor hasn't been tough on fees.

Now, before we sensationalize this matter, perhaps we should acknowledge that its significance could fade fast if Governor Romney defeats President Obama next month. Odds are good that a Romney-appointed Labor Secretary won't employ an assistant secretary who believes in the disinfecting power of sunlight as zealously as Phyllis Borzi, the current chief of the DoL's Employee Benefits Security Administration (EBSA).

Having said that, let's assume that Obama wins the election and that the Labor Department will try to enforce the letter and spirit of ERISA regulations 408(b)(2) and 404(a)(5) in earnest.

In other words, let's assume that Obama's crusaders will push plan sponsors to benchmark their plans' fees, send out requests-for-proposals and, ultimately, purge advisors who, through negligence or complicity, have allowed recordkeepers and fund companies to play the revenue-sharing game at participants' expense.

Tom Gonnella, senior vice president of corporate development at Denver-based Lincoln Trust Company, is among those who see fee disclosure as a major opportunity for his firm. He has already used the fee issue as a wedge to win new business. And, far from having to lower his own fees to get new clients, he finds that he can charge a premium because he reduces the costs of other service providers by so much.

"It's easier to get clients" since the disclosure rules went into effect, Gonnella said at the Financial Planning Association's Experience 2012 conference in San Antonio two weeks ago, where he served on an panel on this topic.

"Retirement plans are expensive. You'll find that there are plans that cost over 200 basis points. So we might save somebody $50,000 in fees right away. We made our TPA (Third Party Administrator) clients look like heroes to the plan sponsors. As a result, we've actually been able to raise prices," he said.

But that's only one side of the story. While Gonnella sees the upside of fee disclosure, Mike DiCenso, president of Gallagher Fiduciary Advisors LLC of Itasca, Illinois, who appeared on the same FPA panel, worries that it will backfire. He sees a potential for fee disclosure to hurt participants by compelling plan sponsors to reduce costs without regard to quality. Indeed, this is happening already, he said.

"There is absolutely margin compression going on," DiCenso said with chagrin. To combat it, he said, advisors will need to do two things: get lean and sharpen their value proposition. Sloppy generalists, he inferred, will be vulnerable. "If you don't identify and go after the right target market, and if you don't get more efficient, you'll find that there are enough advisors out there who will undersell you on price and make it up on volume."

He anticipates lots of pressure from the DoL. "The regulatory environment is increasing," he said. "The state and federal agencies are not on same page. There will be an increase in the number of auditors and the number of audits, with a huge emphasis on fees."

DiCenso concedes that the DoL is right to be worried that Americans aren't saving enough. But he's not so sure that fee reduction per se is the best solution, or that plan advisors and other providers should be the scapegoats for participants' own failures to save for retirement.

"If you look at the number of people with low savings, you can see why the government is taking action," he said. "But, unfortunately, we have a litigious society instead of an accountability society. People aren't looking inward for responsibility. They look to hold other people accountable, not themselves."

As in so many other areas of the regulatory world, the slippery word "reasonable" is causing tremendous confusion and anxiety in the realm of retirement plan fees. A fiduciary—and both plan sponsors and advisors are fiduciaries under ERISA—must ensure that plan fees are "reasonable." But reasonableness is notoriously difficult to define.

On the one hand, plan sponsors can tell fairly easily if a plan's investment expenses, which make up some 80% of all fees, are higher or lower than average. (The average is 127 basis points, within a range of 87 to 162 basis points, not counting outliers.) But above-average fees can still be reasonable as long as the quality or quantity of the services provided justifies them.

It's too soon to say how all this will end, or whether the new regulations will ultimately succeed in making the U.S. workforce better-prepared for retirement. In the meantime 408(b)(2) and 404(a)(5) have put the advisory relationships in many of the smaller 483,000 defined contribution plans in the U.S. into play. The nimble will win. The snoozers will lose.

One useful tip from the members of the FPA panel: Due to a weakness in the regulations, many fund companies still don't provide plan sponsors with enough information to determine exactly how much (in dollar terms, as opposed to percentages of assets) plan participants pay for each investment option. An advisor, they suggested, can add immediate value by deciphering the data and exposing the actual costs in terms of dollars and cents.