
Fee disclosure puts thousands of plan advisor jobs in play

By Editor Test Thu, Oct 4, 2012

For nimble plan sponsor advisors, 408(b)(2) and 404a-5 open new opportunities. For the less nimble, the new regulations mean job insecurity. But will fee transparency reduce fees at the expense of quality? That is the question.

Ever since the Department of Labor's two new fee disclosure rules went into effect at the beginning of July and the end of August, a debate has festered among plan sponsor advisors.

Ignoring for the moment the fact that many reasonable people can see this issue from both sides, let's say that a trench has been dug between the following two camps:

- Plan advisors who worry that plan sponsors will become obsessed with reducing fees, even if it means sacrificing quality, and that they will fire good plan sponsors in favor of carpet-bagging low-bidders.
- Plan advisors who can't wait to use evidence of higher-than-average plan fees as a way to disenchant plan sponsors with their current advisors, no matter competent and client-centric he or she had been.

Now, before we ratchet up the suspense level, we should acknowledge that this controversy will fade fast if Romney defeats Obama. Odds are good that a Romney-appointed Labor Secretary won't employ an EBSA deputy who believes in the disinfecting power of sunlight as zealously as Phyllis Borzi does.

Having said that, let's assume that Obama wins this highly consequential battle-of-straight-arrows and that his Labor Department will try to enforce the letter and spirit of ERISA regulations 408(b)(2), which requires service providers to disclose fees to plan sponsors, and 404a-5, which requires plan sponsors to disclose fees to plan participants, in earnest.

In other words, let's assume that Obama's crusaders will push plan sponsors to act in what they believe is the best long-term interest of participants: to benchmark their fees, send out new requests-for-proposals to competing plan advisors if necessary and, ultimately, purge advisors who have been AWOL or 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 an opportunity. He has already used the fee issue to win new business.

"Now it's easier to get clients," said Gonnella at the Financial Planning Association's Experience 2012 conference in San Antonio last week, 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 can 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.

While Gonnella sees the upside of fee disclosure, Mike DiCenso, president of Gallagher Fiduciary Advisors LLC of Itasca, Illinois, who appeared on the same panel, worries that it will backfire. He sees potential for fee disclosure to hurt participants in the name of helping them by reducing the quality of the services they receive.

“There is absolutely margin compression going on,” he said with undisguised chagrin. “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.”

“The regulatory environment is increasing,” he said. “The state and federal agencies not on same page. There will be an increase in the number of auditors and the number of audits, with a huge emphasis on fee disclosure.”

Gallagher concedes that the DoL is right to be worried that Americans aren’t saving enough. But he’s not so sure that fee reduction is the solution, or that plan advisors should take the heat for participants’ own failure to save.

“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 word “reasonable” is causing tremendous confusion and anxiety in this case. A fiduciary—and both plan sponsors and advisors are fiduciaries under ERISA—fees must be reasonable. But reasonableness isn’t necessarily self-evident.

Plan sponsors can easily tell whether their 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 be reasonable if the service quality justifies them.

It’s too early to say how all this will end, or whether it will produce a workforce that’s better prepared for retirement. In the meantime 408b2 and 404b5 have put the advisory relationships in many of the smaller 483,000 defined contribution plans in the U.S. into play. As always, the nimble will win, and the snoozers will lose.

One useful tip from the panel: Due to a weakness in the regulations, many fund companies still don’t provide plan sponsors with enough information to tell exactly how much (in dollar terms, as opposed to percentages) the plan participants are paying for investments. Plan sponsors will be grateful to an advisor who can decipher the data and show them what their expenses actually are.