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Your Advisor's Fee Benchmarking Report Might Document a Fiduciary Breach and/or a Prohibited Transaction

By Bradford D. Creger, President & CEO

Did your retirement plan advisor ("RPA") provide you with a fee benchmarking report to justify the "reasonableness" of the investment advisory fees that your retirement plan is paying? These fee benchmarking reports are a by-product of the new final 408(b)(2) regulations and are typically being produced by the RPA in an effort to provide the responsible plan fiduciary ("RPF") with documentation that the plan is paying a "reasonable" fee to the advisor.

Unfortunately, these fee benchmarking reports have not been recognized by the courts. In fact, there is even a U.S. Supreme Court case that provides guidance into the process of determining the reasonableness of fees. Most importantly, the courts have basically disavowed the use of benchmarking in determining the reasonableness of an investment advisor's fees.[1] Since these benchmarking reports might not be useful for their intended purpose, what else might they be inadvertently used for? In today's litigious world, and depending upon what is documented in these reports, it's easy to conclude that plaintiff's bar or a regulator could use them as proof of a potential fiduciary breach and/or a prohibited transaction.

408(b)(2) and the Rise of Fee Benchmarking

Let's begin with the reasons why fee benchmarking has become a common tool within the retirement plan industry. The new final 408(b)(2) regulations clarify an obligation on the part of the RPF to examine all contractual relationships between its plan and a party in interest to determine both the necessity of the services being paid for with plan assets as well as the reasonableness of the amount paid for those services.

Because ERISA does not define the term "reasonable compensation" it is up to the RPF who approves a transaction (on behalf of the plan and its participants) to determine the "reasonableness" of the fees that are being paid.

At the same time, and due to the 408(b)(2) disclosure requirements, RPAs were obligated to provide the RPF with an annual statement not only showing the total compensation they received from plan assets, but also a list of the services being provided to the plan for the fees (or commissions) being paid to them. This new compensation disclosure requirement prompted RPAs to begin providing fee benchmarking reports in an effort to justify their compensation. The primary purpose of these fee benchmarking reports is to provide

[1] See TFRG's April 2017 Client Alert: "Is Your Retirement Plan Advisor Overcharging Your Plan?" for a more complete discussion of this topic.

the RPF with a comparison of the fees being charged to their plan against similar retirement plans of similar asset size such that the RPF can then rely on these reports to satisfy their fiduciary responsibility of ensuring that only "reasonable" fees are being paid.

Benchmarking and Documenting Services

As mentioned earlier, 408(b)(2) also requires that a list of services is disclosed. In an effort to justify the fees that many RPAs had grown accustomed to receiving, many of these advisors opted to include everything they might have done previously (without direct compensation) as a "service" being provided by them to the plan. Unfortunately, many of the "services" that are typically being included in the fee benchmarking reports produced today may be problematic and could cause regulatory, legal and/or other troubles for the RPF and their plan.

Problematic Services Identified

The RPA's primary function is to help the RPF select and monitor the investment options offered within the retirement plan. Secondarily, the RPA should help the RPF in providing investment education to plan participants.

Many of the "additional services" that are being touted by today's RPAs have been added to their list of services offered in an effort to resist the significant fee compression that has occurred in the retirement planning industry. Yes, fee compression has mostly been at the mutual fund level and has affected the money managers and record keepers servicing the retirement plans, but fee compression is beginning to affect RPAs as well.

In response, the typical RPA has added administrative and other non-investment services to their service model in an attempt to justify maintaining the compensation levels that they have enjoyed in the past. Unfortunately, these benchmarking reports may document services that are potentially problematic (see chart below.)

The Future of Retirement Plan Advice

We see a trend that will be challenging for many "old guard" RPAs. Let's first agree that it should take roughly the same amount of time and effort for an advisor to deliver services to a plan with $50 million or with $10 million in assets under management ("AUM"). If this is true, why is an advisor paid a premium to service the larger plan? Many would argue that above certain levels of plan assets, having a compensation model based on AUM is antiquated and results in "unreasonable" compensation being paid to the RPA.

A flat fee arrangement that doesn't require elaborate justification using benchmarking reports might not only result in lower investment advisory fees today, but it might also help the RPF avoid future headaches.

Direct Dial:	626-376-9777
Toll Free:	800-984-TFRG
Email:	bdcreger@tfrgroup.com
Website:	www.tfrgroup.com

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Service Provided	Potential Problem	Rationale
Plan Design Consulting	Prohibited Transaction	Plan design is a Settlor Function and is not something that can be paid for using plan assets. Having this service included in your Fee Benchmarking Report provides written documentation of a potential Prohibited Transaction and a potential breach of the RPFs fiduciary duty.
Compliance Oversight	Administrative Duty	When the RPA provides compliance oversight for a plan, this is an administrative act. This could potentially result in the RPA being deemed an administrative "functional fiduciary" which is typically not covered in their E&O insurance policy.
Document Vault	Administrative Duty	When the RPA provides document storage for any plan documents created by another Plan Vendor, this is an administrative act. This could potentially result in the RPA being deemed an administrative "functional fiduciary" which is typically not covered in their E&O insurance policy.
Vendor search, Vendor fee and service reviews and/or Vendor management and issue resolution	Potential Administrative Duty	Other than dealing with the investments and/or the record keeper, when the RPA provides any administrative services related to any other Plan Vendors, this may be an administrative act. This could potentially result in the RPA being deemed an administrative "functional fiduciary" which is typically not covered in their E&O insurance policy.
Participant Enrollment Meetings	Value to Plan is Questionable	Most Plan Providers (i.e. record keepers) will provide the plan sponsor with people to do enrollment meetings at no additional cost. Paying additional fees to your RPA for something the plan can request and obtain for no additional cost is a potential waste of plan assets. This may potentially result in breach of the RPFs fiduciary duty.
Fiduciary Training	Potential "quality and consistency of service" problems, including cost disadvantages	Providing fiduciary training to plan trustees or investment committee members is potentially better delivered at a lessor cost through any one of the numerous "fee for service" web-based and on-demand training programs that are available. This may potentially result in breach of the RPFs fiduciary duty. The RPA also runs the risk of providing legal advice without a license to practice law.