

The Dual Registrant's ERISA Duel

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ERISA reform changing the game for broker dealers

For the last seven years, the independent hybrid broker dealer community has represented one of the fastest growing sectors in our industry. More flexible policies and procedures, broader access to products and services, support of Independent Adviser Representative (IAR) activity and higher payouts have driven producers away from financially and strategically stressed large wirehouses in droves.

Retirement plan producers specifically have represented a large percentage of this movement. These producers need access to open architecture environments and other tools and resources that enable them to align with their Employee Retirement Income Security Act (ERISA) clients in an unbiased, objective and fiduciary capacity.

Wirehouses, captive agencies and some insurance-company-owned firms have historically been laden with self dealing issues and conflicts preventing them from engaging with customers in an ERISA fiduciary capacity. In addition, major firms deal with managing massive numbers of producers and need to protect the firm's exposure by limiting ERISA activity that carries fiduciary liability.

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and producer to reassess how they engage and/or consequently do not engage with ERISA clients.

There is no way to downplay the significance of the impact of these regulations. ERISA activity intersects with almost every major business line, including brokerage, mutual funds, managed assets, insurance, annuities, financial planning and employer services.

Independent broker dealers face challenges in regards to assisting their dual-registered producers who can act in either a registered representative and/or IAR capacity who know what they can do and when in order to maintain a compliant practice. Training and education have become a must. Independent hybrid leaders such as United Planners are setting the bar by requiring advisors that provide fiduciary services to retirement plan clients in order to maintain certain retirement centric professional designations such as the AIF, CRPS (Accredited Investment Fiduciary, Chartered Retirement Plan Specialist).

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that advisors truly understand their role as a fiduciary and to truly embrace the fiduciary advice model”, says management at United Planners. Not only does training assist with mitigating risk by fostering “best practices”; there is a direct correlation between education and increased overall production.

Of the sweeping reform, the most impactful regulations on financial service providers are the plan level fee disclosure under ERISA 408(b)(2) and participant-level-disclosures under 404(a)(5), both of which are final and become effective in April, 2012. Along with changes to the Form 5500 Schedule C, these changes are part of a three pronged strategy designed to facilitate the exchange of information between service providers, plan sponsors, participants and the DOL. In addition, the DOL has issued a proposed rule that seeks to redefine the scope of activities giving rise to fiduciary status under ERISA, which cannot be ignored in the strategic decisions being made today.

408(b)(2) was implemented to require service providers to employer-sponsored plans to disclose information to help plan fiduciaries understand the reasonableness of the fees being charged for the plans services and assess potential conflicts of interest that might affect the quality of those services. The regulation specifically requires all “covered” service providers (those earning more than \$1,000 for plan services) to deliver written disclosures regarding the following: a) services to be provided to the plan and/or its participants; b) any and all direct and/or indirect compensation received by the service provider (and affiliates); c) a statement acknowledging any of the services that are reasonably expected to give rise to fiduciary

status under ERISA or the Advisers Act; and d) any compensation in connection with termination of the contract.

The participant disclosure requirements under ERISA 404(a)(5) were implemented in order to improve the information regarding expenses and fees to participants, enabling them to make more informed decisions. In its final form, ERISA 404(a)(5) requires plan sponsors to provide each participant, or beneficiary, with two categories of information: (i) plan-related information, including general plan information, administrative expense information and individual expense information; and (ii) investment-related information, including performance data, benchmarking information, fee and expense information, Internet Web access to investment related information, and a glossary to assist participants with investment-related terminology. The new rule requires that this information be provided in a comparative format. Also, the information must be written in plain language that the average participant can understand. The DOL has provided a “sample” model comparative chart; http://www.dol.gov/ebsa/compliance_assistance.html#section3. Although not required, use of it ensures compliance.

Broker dealers shifting their paradigms to mitigate risk

The disclosure requirements present a series of challenges to financial service providers. Every broker dealer is wrestling with how to comply with these regulatory requirements, support competitive sales activity and mitigate risk. The stakes are high. Fiduciary status under ERISA carries with it the highest duty of loyalty and prudence.

In order to stay competitive, wirehouses will need to be proactive by training producers on the new regulatory requirements and how to retool and position a suite of meaningful non-fiduciary services, such as committee education, participant education, vendor search and benchmarking, participant inquiry support and fee disclosure support.

ERISA fiduciaries are subject to strict rules concerning prohibited transactions and personal liability. The DOL has vowed to make enforcement an aggressive part of this administration's agenda. More than 100 new enforcers are in place, in addition to an estimated budget of \$153 million to be spent during the first year to review the regulation and conduct compliance reviews.

ERISA compliance is important because failure can result in serious penalties such as fines ranging from 5 percent to 100 percent of the amount involved; excise taxes; civil or criminal sanctions, including prison sentences; or even plan disqualification resulting in the loss of favorable tax treatment for the plan sponsor as well as participants and beneficiaries. No wirehouse or producer wants to be the first "example."

We are seeing how the marketplace is reacting to managing this risk and the future of major wirehouses seems pretty clear. The majority of their producers are registered representatives who will be limited to "approved" commissionable products and will be limited to "approved" non-fiduciary services. In reaction to this shift, most 401k product providers are integrating 3(38) investment managers to fill the investment advice gap to help registered representatives retain existing business and compete in the marketplace.

Registered representatives will soon face the challenge of answering the following questions from both plan sponsors and participants: how much do you make? If you do not help me select, monitor and replace investments, what do you do? How do these "disclosed" conflicts of interest impact our business relationship? These questions will make those who are unprepared very uncomfortable.

In order to stay competitive, wirehouses will need to be proactive by training producers on the new regulatory requirements and how to retool and position a suite of meaningful non-fiduciary services, such as committee education, participant education, vendor search and benchmarking, participant inquiry support and fee disclosure support. Historically, wirehouses and registered representatives have not done a good job of disclosing fees and articulating services in the commissionable environment.

While plan sponsors have always been required to evaluate the reasonableness of arrangements with service providers, most did not question services that were paid from the expenses charged against participants' investments (e.g., 12b-1 fees). The new regulation—in conjunction with changes to plan sponsors' required disclosures to participants and enhanced reporting to the DOL through the Form 5500 Schedule C—are expected to lead to increased scrutiny of the value of a retirement plan producer's services in light of the compensation received.

The dual registered reps "duel"—to be or NOT to be a fiduciary?

The role of a registered representative is becoming clearer. However, dual registrants of hybrid independent firms face big decisions and a "duel" of sorts: "to be or not to be a fiduciary?" Dual registrants need to ask; "How can I, should I, do I, want to engage with ERISA clients?" All of a sudden, the flexible attraction of the independent marketplace is leaving many hybrid producers lost at sea with no clear answers and direction as to how to position their ERISA and/or non-ERISA services within their practice.

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In today's environment, it is just as important to know what NOT to do even if you don't want to act in a fiduciary capacity. Very few independent broker dealers have the internal expertise to drive these decisions. Many firms are paralyzed by the overwhelming complexity of the disclosure regulations. To start, most firms have no idea how many retirement plans they have under management and/or advisement. Although independents have kept their costs down and payouts high via limited internal resources, first movers are gearing up to acquire the necessary support. The hybrid model is right in the crosshairs of the DOL's primary areas of scrutiny. All dual registrants need to be proactive and assess their practice, themselves and their firm:

1. Assess your current business; how many qualified plans do you have under management? Fee-based plans? Commissionable plans? What percentage of your overall business do qualified plans represent? What percentage of your overall practice could retirement plans represent? Do you work with plan participants? What percentage of individual business came from qualified plans? What percentage of qualified plan business came from individual clients? Do you provide financial planning and advice on 401k assets? Where is the highest revenue potential? What services do you provide? What new services do you need to provide? What services do you enjoy providing the most? Least?

2. Assess your risk; Are you comfortable with your personal knowledge of ERISA requirements? Which activities present the

most and least risk? How much risk are you comfortable with? How is your practice aligned to mitigate risk and scrutiny? How do you engage with plan participants? If necessary, can you demonstrate that you do not "proactively" solicit rollovers? Do you know the difference between advice and education? Are your fees reasonable? Can you substantiate that your fees are reasonable to your plan sponsors, participants and the DOL? What if you are the advisor to a qualified plan and the participant wants to work with you in an individual capacity? Would you work with the participant in a fee and/or commissionable capacity?

3. Assess your firm; Does your firm employ professionals in a sales, legal and/or compliance capacity? Do they have specific experience with managing ERISA services in a hybrid capacity internally and/or externally? Does your firm's Errors & Omissions' coverage support your activities? Does your firm provide any kind of training and/or written policies and procedures to assist you? Does your firm provide you with competent and accurate contracts and disclosures? Can your firm provide you with direction on how to maintain best practices while working with both plans and participants in either a fee and/or commission basis? Does your firm provide you with training, tools and resources? Will your firm allow you to acknowledge your fiduciary status to the plan?

Dual registrants face a myriad of important choices in today's world. Most hybrid producers work with both plans and individuals, so having access to both product suites is ideal. For example, for small or

start-up companies, commissionable product providers have many bells and whistles built into their offerings that make it an attractive option for both the client and producer, such as professional plan sponsor and participant reports, bilingual communications, enrollment support, toll-free access, fiduciary support and indemnification. When companies reach the \$3-5 million thresholds, the fee-based environment comes into play, enabling the advisor to offer lower cost funds and move the plan into an open architecture environment.

Adapting to change and following the leaders

Philip Steele of Pension Architects¹, was one of the first pioneers to go to a fee-based/commission model in 1981. Steele works exclusively offering Retirement Plan Services. Today, his practice consults on more than 100 plans with more than \$1 billion in assets under advisement. He has found that operating in a dual capacity continues to be essential to his firm's growth and success because it offers both independence and access to tools, resources and experts. His story is a little bit like Goldilocks – the big firms too restrictive, small ones not enough support and/or security.

Having performed due diligence on almost all, Steele chose a mid-sized independent broker dealer and RIA firm (United Planners Financial Services) in 2009 which he says feels is “just right” and has a “bench” deep enough to support his retirement needs. Steele comments that no two plans or producers are alike – hence the driving factor behind the operative word in his firm's name “architects”. Steele has a team of 15, all of whom have the AIF des-

ignation, and depending on their role, may also hold the CFA or CFP designations. He actually prefers to hire people that have no experience so he can put them on a career track that ultimately immerses them in the ERISA consultative mindset. Hybrid firms continue to offer producers the most viable means to design one's practice and Steele has never been bashful about getting expert opinions when needed. What attracted him to United Planners is not only their commitment to the ERISA marketplace but the “progressive and collaborative mindset of both the producers and home office, which create a highly productive and rewarding environment.” The regulatory reform is throwing all of us into uncharted territory and knowing that you have “access to this mindshare and best practices is very important and motivating.”

According to top Retirement Plan producers, the trick to establishing an ERISA practice in a hybrid environment is to keep it simple and validate your activities. Clearly define what services are going to be offered, both fiduciary and non-fiduciary. For consistency, the same suite of non-fiduciary services should be offered to both fee- and commission-based clients. Fiduciary services typically include Investment Policy Statement (IPS) development, investment selection and monitoring, and vendor search and analysis. First movers are positioning emerging non-fiduciary services such as participant education on expenses and fees, disclosure management assistance, vendor analysis and benchmarking, and participant inquiry management assistance.

Plan sponsors need help managing their 408(b)(2) requirements in addition to bracing for the tsunami of participant inquiries

1. Pension Architects is an Independent RIA.

About United Planners

United Planners (UP) is a Registered Investment Advisor and full-service Independent Broker-Dealer uniquely structured as a Limited Partnership. Representatives enjoy association with a stellar organization and rave about the culture, flexibility and true independence they experience beginning day one. High payouts, profit sharing, technology, service, marketing support and RIA flexibility (including the support of Independent RIA's) are among some of the most favored features.

UP has established strategic relationships with open architecture service providers within the ERISA market giving our Advisors the capabilities and tools to manage and grow their practice while adhering to our high Fiduciary Standards.

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about to hit in 2012 when they see the fees they are being assessed for the first time. More than 70 percent of participants are under the impression that their 401k plans are being managed for free. The DOL has vowed to step up examination and enforcement; participant complaints are the number one source of initiating investigations.

Pricing and substantiating services is critical in this new world. There are many ways to approach pricing. The fee-based retirement plan marketplace is still relatively young. Subsequently, the good news and bad news is that there are few established industry standards. Metric considerations could be driven by size, assets, number of participants, complexity of plan, risk, number of hours involved in vendor search, management, meeting preparation, employee and employer meetings and other services in addition to an advisor's experience, qualifications and expertise.

Managing a fee-based practice is forcing advisors to think about their time like a good CEO. Fee transparency is creating better accountability, stronger client relationships and with that often comes increasing revenue. Fee compression is a myth in the \$2 to 25 million marketplaces. In many cases, these services are already being provided, but not sufficiently articulated to the customer.

In regards to managing and delivering services such as the IPS, investment monitoring, vendor search and fee bench-

marking, advisors can leverage several cost-efficient third party tools. These tools are essential for business management, maintaining best practices and mitigating risk. They help practitioners follow a documented process with the client when selecting or removing a fund, in addition to selecting or replacing a service provider. Your broker dealer or hybrid firm should make such tools and resources available to you.

In regards to the ERISA "duel," "to be a retirement plan fiduciary or not to be?," the answer is the same. Both registered representatives and investment adviser representatives need to be educated on the regulatory reform, examine how it impacts their practice and strengthen their suite of non-fiduciary services. First movers that understand these new needs and position plan sponsor and participant disclosure services into their paradigm will be well poised for growth. Plan sponsor and participant needs have never been greater. If you choose to offer fiduciary services, you should surround yourself with experts and expertise in order to maintain proficiency, best practices and mitigate risk as you grow your business. It is critical that you partner with a broker dealer or hybrid firm that has a strong infrastructure to support your retirement plan business model. The opportunities are too great and the risks too high for you not to carefully evaluate where you call "home" as we enter this new ERISA era. ■

This paper was a joint effort between United Planners, *Registered Rep.*, and Amy Glynn from the Pension Resource Institute, LLC.

