

Emerging Trends for PPA Fiduciary Advisers

by Jason C. Roberts

Recognizing the need for professional investment advice for participants and beneficiaries of defined contribution plans, the Pension Protection Act of 2006 (PPA) fashioned a new category of investment specialist—the fiduciary adviser. If an adviser adheres to certain enumerated procedures relative to compensation and disclosures, he or she can now deliver individualized investment advice to plan participants.

Since the passage of PPA in 2006, broker-dealers and registered investment advisers have been scrambling to synthesize PPA's investment advice provisions and determine how best to execute and support the fiduciary adviser business model. This article provides a brief overview of the investment advice provisions of PPA and examines the emerging business structures being implemented by broker-dealers and registered investment adviser firms in response thereto.

Overview

In examining the various approaches undertaken thus far, it is clear that these firms view the PPA fiduciary adviser as a conduit by which to maintain and grow their assets under management through capturing participants' household assets and rollovers. Firms are able to access participants' assets held outside of the plan by offering a comprehensive financial planning option as part of the initial client assessment and engagement. In addition to receiving recommendations on contributions and allocations within the plan, participant assets held outside of the plan are placed into a wrap account where the adviser's compensation is level.

With respect to rollovers, 401(k) plans perpetually lose participants with the highest balances as they retire and withdraw these assets. By becoming or partnering with a fiduciary adviser, registered representatives and investment adviser representatives are hoping to be in the best position to offer guidance to participants who are seeking to consolidate investments and/or rollover assets into an IRA.



Pursuant to ERISA Section 3(21)(A)(ii), any person who renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of a plan, or has any authority or responsibility to do so, is a “fiduciary.” The prohibited transaction provisions of ERISA and the Code prohibit an investment advice fiduciary from using the authority, control or responsibility that makes it a fiduciary to cause itself, or a party in which it has an interest that may affect its best judgment as a fiduciary, to receive additional fees. As such, in the absence of a statutory or administrative exemption, fiduciaries are prohibited from rendering investment advice to plan participants regarding investments that result in the payment of additional advisory and other fees to the fiduciaries or their affiliates. Section 601 of PPA added a statutory exemption under Section 408(b)(14) of ERISA [and Section 4975(d)(17) of the Code] for investment advice rendered pursuant to an “eligible investment advice arrangement” (EIAA). An EIAA is a contract between the fiduciary adviser and the plan sponsor that guarantees that the adviser's compensation will not vary on the basis of any investment option selected.¹

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The fiduciary adviser must acknowledge his or her fiduciary status in writing and can only be held civilly liable for losses caused by a breach thereof on those accounts where he or she has delivered investment advice. Such breaches are also subject to civil and criminal penalties by the DOL and the IRS.

Plan sponsors, on the other hand, are relieved from liability on those accounts as long as they can demonstrate prudent selection, monitoring and compliance² of the fiduciary adviser. PPA does not require plan sponsors or co-fiduciaries to monitor the specific investment advice given by a fiduciary adviser to any particular recipient of the advice.

PPA allows fiduciary advisers to charge reasonable fees, which based upon the extent of the services offered, are ranging from \$300 - \$1,500 per participant. Many firms are allowing these fees to be deducted from plan assets or paid from participant accounts, depending upon the desired usage. For example, in plans where the majority of employees are making substantial contributions (*i.e.*, hospitals, law firms, etc.) fiduciary adviser firms are seeking to have fees deducted from the plan, thereby encouraging more participants to opt for individual advice. In plans with low average balances, where the majority of participants are invested in qualified default investment alternatives (“QDIAs”), firms are encouraging the plan to deduct advisory fees from participant accounts. The belief is that only those with significant assets are likely to engage the fiduciary adviser, leaving the fiduciary adviser with more time to service senior employees with higher balances.

As discussed, many firms are using fiduciary advisers to reach participants’ household and rollover assets. An estimated one in ten employees who will use a fiduciary adviser has household assets averaging \$150,000, and one in 20 will be in a position to rollover plan assets averaging \$500,000. In order to issue a suitable recommendation, a fiduciary adviser will need to review and consider the participant’s overall financial situation including assets and investments held outside of the plan. By offering a comprehensive financial planning option to participants, some firms are betting that participants will seek to consolidate their finances *and* deal with a single investment professional.

According to an August 2007 study by Spectrem Group, 67 percent of individuals who completed a rollover during the two-year period through April did so with the help of a

professional adviser. The same study showed that the higher the balance, the more likely there’s an adviser involved in the decision. With nearly \$500 billion now eligible for rollovers, and that amount is expected to increase 10 to 12 percent annually over the next five years, firms are looking to their fiduciary advisers to be in the best position to capture their participants’ rollovers.

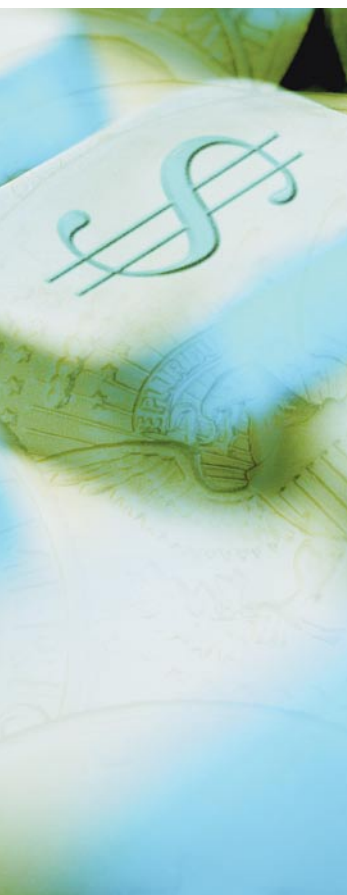
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There are three basic business structures emerging to facilitate such relationships: (1) stand alone; (2) full service team; and (3) partnerships. The pros and cons of each arrangement is being determined by the relative expertise of the individual advisers, their average plan size (both in terms of participants and assets), preexisting affiliations and considerations relating to revenue distribution.

PPA does not prohibit advisers from acting as both plan-level and participant-level fiduciary advisers as long as their compensation is unaffected by the investments recommended by the fiduciary adviser. Under the stand alone model, the unconflicted plan-level adviser is, therefore, permitted to act as both an adviser to the plan and as a fiduciary adviser to plan participants. Given the obvious limitations on the adviser’s time, this arrangement is being employed by advisers with a book of business consisting primarily of plans with high average balances.


Alternatively, groups of advisers who are able to meet the level compensation and other requirements are seeking to capitalize on their collective strengths by forming full service teams. Under this arrangement, the plan adviser practice employs one or more fiduciary advisers and/or associate advisers. Associate advisers are not parties to the EIAA with the plan sponsors but provide the administrative services under the supervision of the named fiduciary adviser. This arrangement permits the full service team to scale their business by hiring and replacing associate advisers without altering the EIAA. Because there are no restrictions on how fiduciary adviser revenue is distributed, the full service team can determine how each member is compensated and are free to dedicate their revenue towards external expenditures.

Under the partnership arrangement, a plan adviser practice has an exclusive arrangement with a fiduciary adviser practice, and each partner participates in the revenue of the other. The level compensation requirements are not violated so long as the fiduciary adviser does not recommend plan related services to participants for which a



partner is paid (*i.e.*, recommending investments to participants that are not in the current lineup that would trigger a vendor search).

Conclusion

By implementing any of the aforementioned arrangements, broker-dealers and registered investment advisers are looking to grow assets by building meaningful personal relationships with participants through fiduciary advisers. While nothing in PPA prohibits fiduciary advisers from managing a participant's household assets, DOL Advisory Opinion 2005-23A (the "Deseret Letter") cautions plan fiduciaries with respect to advising participants to take a distribution and invest the proceeds in an IRA account managed by the fiduciary. Given that PPA requires fiduciary advisers to acknowledge their fiduciary status in writing, fiduciary advisers and their respective firms should determine whether such arrangements would be in violation of ERISA Section 406(b)(1), which prohibits a plan fiduciary from using plan assets in his or her own interest. 



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- 1 PPA also includes provisions for parties in conflict to provide advice through a computer model. This second conflicted advice program is not discussed in this article.
- 2 PPA requires that an independent expert conduct an audit of the fiduciary adviser to determine compliance with the provisions of Section 601 of PPA.

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