Choosing the Right Type of Investment Assistance

To Have or Not to Have Fiduciary Advice

Previously

In our previous installment, we examined the difference between a 3(21) versus a 3(38) investment fiduciary. In this installment, we look at the three traditional models for how investment-related services are delivered to retirement plans and when it is preferable for a plan sponsor to use each type. In our next installment, we will consider the due diligence measures which should be followed in making that selection.

Introduction

Plan sponsors often need help selecting the investment options for a plan, so they may wish to engage professional assistance. Choosing what type of help may seem like a confusing task. Many TPAs bring extra value to a relationship by educating the plan sponsor about what types of guidance are available and what impact each type may have on the sponsor's own fiduciary liability.

There are three traditional models for delivering investment options to retirement plans: registered representatives, investment advisors and investment managers. Each arrangement offers a different level of service and protection to plan fiduciaries, and different compensation rules apply to each model.

Registered Representative

Kimberly Shaw Elliott

A registered representative of a broker-dealer provides investment education that assists the plan sponsor in making investment choices for the plan. The plan sponsor retains full discretionary authority to select the plan investments and uses information gained from the registered representative to guide his or her own decisions. Since no investment advice is given and no investment authority is granted, the registered representative is not a plan fiduciary and is not held to a fiduciary standard of care. He or she is not bound to avoid conflicts of interest.

Since a registered representative is not a fiduciary, he or she may receive commissions and other charges assessed against each transaction, whether it is a buy or a sell. These commissions may vary, based upon the investment choices made. Revenue sharing is permissible and is a means to compensate the registered representative for continuing to service an account after the original commissions have been earned.

Investment Advisor

An investment advisor representative ("IAR") delivers services on behalf of a registered investment advisor. As we learned in our first installment, an IAR gives investment advice and is a fiduciary as defined in Section 3(21) of ERISA and under the Investment Advisers Act. When using a 3(21) investment advisor, the plan sponsor retains investment authority but uses the recommendations made by the advisor when selecting the investments. The plan sponsor and the advisor therefore share the fiduciary responsibility for the funds.

An Investment advisor receives an annualized fee, based upon the value of the assets in the program. This level fee is payable each period, regardless of the number of transactions actually processed. Because advisors give investment advice, they are fiduciaries to the plans. And, as such, their compensation cannot vary with the investments selected because it would be considered a conflict of interest in which a fiduciary position could be used to influence one's own compensation. The conflict is removed if the compensation remains level, regardless of what investment is selected.

Investment Manager

Finally, sponsors might also select an investment advisor and grant that advisor discretionary authority to make the plan investments him or herself. If the plan sponsor properly appoints and monitors the activity of an investment manager, as defined in Section 3(38) of ERISA (and as discussed in our first installement), the sponsor can be relieved of fiduciary responsibility for the investment choices made by the manager. The properly appointed investment manager bears the sole fiduciary responsibility.

Since a 3(38) investment manager exercises investment discretion, he or she is a fiduciary and must follow the same level compensation scheme as a 3(21) investment advisor, described above.

How to Choose?

A plan sponsor, in considering what type of assistance to seek, must assess his or her own comfort level and skills and select the advisory model that best fits his or her own needs.

A Registered Representative is the best option for plan sponsors who are confident about making all the investment decisions, but would like professional help in gathering information to make those decisions. Choosing this option also leaves sponsors with sole responsibility for those decisions.

Using an Investment Advisor is a good choice for the sponsor who wants to retain the decision-making authority, but needs some guidance and specific investment recommendations to shape their decisions. The sponsor may want someone else to bear part of the investment responsibility as well. The sponsor must be prepared to pay a fee each and every year, regardless of how the investments perform, for the specific guidance and recommendations that the advisor has made over that period.

Choosing an Investment Manager provides the most protection to the plan sponsor, because it also involves relinquishing the most control. Since a third party will be responsible for generating investment ideas and acting upon them, fiduciary liability for the sponsor is removed. While it may sound appealing, this option is not for plan sponsors that wish to retain a partial role in investment process, or for those who are most comfortable with a do-it-yourself operating philosophy.

A summary table of all three options is presented on the next page.

Attributes of Three Models to Deliver Investments to Retirement Plans

	Registered Representative	Investment Advisor	Investment Manager
Fiduciary Status	Is not a fiduciary	Becomes fiduciary by actions, such as providing advice; discloses fiduciary status in writing	Appointed by plan fiduciary in writing; discloses fiduciary status in writing
Standard of Care	May only provide information about products that are suitable to the plan and plan participants	Must put the best interest of the plan and plan participants ahead of his/her own	Must put the best interest of the plan and plan participants ahead of his/her own
Status of Liability	Has no responsibility to make - or advise about - plan investments	Shares investment responsibility with the plan fiduciary	Shifts investment authority from the plan fiduciary to him/herself
Compensation	Commissions and transaction based fees that can vary with the investment selected	Typically annualized fee based upon assets under advisement. Cannot receive additional compensation such as revenue sharing.	Typically annualized fee, based upon assets under advisement. Cannot receive additional compensation such as revenue sharing.

About The Bates Group LLC

The Bates Group is a leading provider of securities litigation support, regulatory and compliance consulting, and forensic accounting services. Its growing list of 50 financial industry experts and damages consultants situated in Lake Oswego, Oregon and throughout the United States has provided expert consulting services on a multitude of topics within these practice areas. With more than three decades of experience working with Fortune 500 companies, leading law firms, financial services companies and regulatory bodies worldwide, The Bates Group continues to set industry standards. More information about The Bates Group is available at www.batesgroupllc.com.

Bates Group, LLC | 5005 SW Meadows Road, Suite 300 | Lake Oswego OR 97035 | Tel: 503.670.7772

http://BatesResearchGroup.com | research@BatesGroupLLC.com

BATES RESEARCH GROUP