

THE NEED FOR A PROFESSIONAL INVESTMENT ADVISOR

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THE ENVIRONMENT FOR RETIREMENT BENEFITS

Consider recent history involving Enron and WorldCom corporate fiascos affecting Employee Retirement Income Security Act (ERISA) legislation and the mutual fund trading scandals where participants were late day trading and market timing with overseas investments. The result was the Mutual Fund Reform Act of 2004. Other laws such as the Sarbanes-Oxley Act of 2002, the American Job Creation Act of 2004 (nonqualified plan legislation) and new IRS regulations impacting 403(b) plans have operated to impact plan sponsors' concerns.

In addition, fee disclosure has been a legal issue that is closely followed by the industry and law suits against plan sponsors are starting to occur. The Pension Protection Act of 2006 has also created confusion over the responsibilities for plan sponsors. The Supreme Court ruled in February 2008 that individual participants in the most common type of retirement plan can sue under a pension protection law to recover their losses.

The Corporate Executive Board¹ describes the concerns of plan sponsors as "unprecedented" and lists their new investment priorities as follow:

Managing Fiduciary Risk

- Preventing employee lawsuits
- Understanding new regulatory and compliance requirements
- Improving employee savings
- Monitoring investments and employee fees

Plan sponsors are quickly seeing that they need professional guidance in handling many of the issues surrounding the administration of their plan investments.

A CHANGING STANDARD

Employers are seeking out trusted advisers to provide better insights for their administrative and operational needs. Spectrem Group² reported a change in the employee benefits industry with perceptions of consultants. In 1999, 39% of plan sponsors used outside consultants, however defined, to advise or assist in recommendations for their defined contribution plans.

In 2002 that figure jumped to 59%. With a median size of 1,893 employees, Deloitte³ measured the growth in outside consultants who monitored plans investments from 25% in 2003 to 55% in 2005. Building on their earlier research, Spectrem Group found in a recent survey of plans with 1,000 or more employees that 9 out of 10 plan sponsors used an adviser.⁴ Clearly, behaviors of larger plan sponsors get adopted by medium and smaller plan sponsors over time.

CUSTOMIZED SERVICES

There are myriad services that come with an association with a registered investment advisor. Advisory clients may benefit from:

- Custom Investment Policy Statements
- Custom investment manager searches
- Open architecture for investment managers and mutual funds
- Fee studies analyzing plan costs with action plans
- Comprehensive custom quarterly reports
- Assisting with client investment committee minutes
- Asset spending studies for philanthropic clients
- Asset demographic studies for defined contribution plans [analyzes portfolio construction related to employee populations taking into account service and age of employees]
- Fiduciary education

CAVEAT EMPTOR!

The Securities and Exchange Commission announced the results of the examination of 24 pension consultants registered with the SEC as investment advisers, concerning their compliance with securities laws involving conflicts of interest and disclosure. As a result of the examinations, **the SEC and DOL issued a joint guidance statement⁵ for plan fiduciaries that includes a list of questions that plan fiduciaries should use to evaluate their consultants:**

1. Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?
2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan? If so, describe those relationships.
3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of the payments in relation to your other income (revenue)?
4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being a factor when you provide advice to your clients?
5. If you allow plans to pay your consulting fees using the plan's brokerage commissions, do you monitor the amount of commission paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not over-pay its consulting fees?
6. If you allow plans to pay your consulting fees using the plan's brokerage commissions, what steps do you take to ensure the plan receives best execution for its securities trades?
7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?
8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment adviser to the plan while providing the consulting services we are seeking?
9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?
10. What percentage of your plan clients utilizes money managers, investment funds, broker services or other service providers from whom you receive fees?

Plan sponsors should expect their investment advisers to "sit on the same side of the table" with them. This presumption of freedom of conflicts of interest and unbiased recommendations is often not what many advisors deliver.

¹ *Escaping the Performance Trap*, Retirement Services Roundtable Research, 2006.

² *The Use of Outside Consultants*. Spectrem Group, 2003.

³ *Deloitte Annual 401(k) Benchmarking Survey 2005/2006*.

⁴ *Large 401(k) Sponsors Want Expert Advisers*. PLANSPONSOR, April 17, 2007; Study by Spectrem Group.

⁵ *Selecting And Monitoring Pension Consultants - Tips For Plan Fiduciaries*. DOL and SEC Joint Guidance Statement. June 1, 2006.