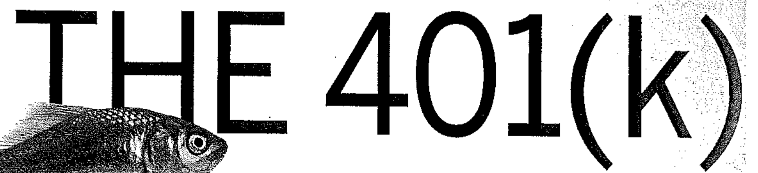

THE 401(k)

AS REGULATORY SCRUTINY OF PLANS INCREASES, ADVISORS ARE IN THE SWEET SPOT TO CAPTURE NEW BUSINESS.

By Ilana Polyak

OPPORTUNITY

At the Philadelphia offices of the Eisenhower Fellowships, the 21-member staff is too busy preparing leaders of the future – in the mold of the late president and military leader – to spend much time thinking about the organization's retirement plan.

For years, the nonprofit's employees were offered a retirement plan that was populated by middling investment choices with high fees. But recently, the trustees took a good hard look at how the 403(b) plan was managed and were shocked to learn that employees were paying between 2% and 3% of assets in fees, not to mention surrender charges of up to 5% for some accounts.

"After fees, the employees weren't making all that much," says Stephanie Gropp, the organization's finance director. What's more, Gropp notes, the organization's endowment was still reeling from the effects of the recession. The trustees were looking for a way to increase employee benefits, but couldn't spend a lot, so a retirement plan that better served staff members looked like an appealing option.

The organization turned to Harvest Financial Partners of Paoli, Pa., a wealth management firm just dipping its toe into the defined contribution market. In 2011, Harvest took the reins of the Eisenhower Fellowships' plan – kicking out poor-performing funds, installing a third-party administrator that charged less, monitoring the investments and even providing individualized advice to employees on saving for their goals. Best of all for Gropp, Harvest helped her sever ties with the plan's previous provider.

Eisenhower now foots Harvest's fee, which John Fattibene, a co-founder of Harvest, says runs between 25 and 50 basis points. Participants, on the other hand, pay less than 40 basis points on average, due to the inclusion of low-cost Vanguard funds with share classes specifically for retirement plans.

"Most businesses take any employee benefit they provide seriously," Fattibene says. "But the retirement plan is nowhere near central to their mission and a lot of times they don't know where to go."

GROWING TREND

Harvest now runs defined contribution plans – both 401(k) and 403(b) – for a handful of companies and organizations, and hopes to sign on more. Though Harvest is still largely a wealth manager – more than 75% of its revenue comes from that line of business – Fattibene and fellow co-founder Jim Wright see greater opportunity in retirement plans.

GETTY

BY ADMINISTERING RETIREMENT PLANS FOR SMALL, LOCAL EMPLOYERS, ADVISORS SAY THEY CAN OPEN THE DOOR FOR OTHER WEALTH MANAGEMENT RELATIONSHIPS.

To be sure, advising 401(k) plans is less profitable than traditional wealth management: 25 to 50 basis points vs. 1%. But those fees aren't the end goal. Rather, by working with small, local employers, advisors say they can position themselves as a destination for rollovers and open the door for other wealth management relationships.

In fact, most RIAs who work with 401(k) plans say they started when a small business owner approached them for help with his or her firm's plan. "An easy way to get started in the business is to ask about the possibilities of helping [your client] with their 401(k) plan," says Todd Clarke, CEO of CLS Investments, an investment management firm in Omaha, Neb.

The timing is right, as plan sponsors are increasingly turning to advisors for help. According to asset management research firm Cerulli Associates, about $151 billion of defined contribution plan assets are now sold through the RIA channel, a number Cerulli expects will rise in coming years.

There are a couple of reasons for the shift. First, the Department of Labor, which regulates workplace retirement plans and individual retirement accounts through the Employee Retirement Income Security Act of 1974, is pressing to apply a fiduciary standard to anyone who advises retirement plans. That's not friendly to broker-dealers, who are held to a less stringent suitability standard.

Further, plan sponsors — that is, the employers — are now required to disclose plan fees to participants. Many sponsors, who at small firms are often the owners and the plans' largest participants, have often been shocked to learn what they've been paying.

FIDUCIARY BURDEN

Small plans like Eisenhower's face a dilemma. On the one hand, they want to provide a retirement plan to employees as a retention tool. Yet those charged with setting up and administering the plan rarely have retirement plan expertise.

"The reality is, this is probably No. 52 on their to-do list," Fattibene says.

There's another layer of complexity: Whatever the staff's experience, the organization has a fiduciary duty to act in the best interest of participants. And increasingly, plan sponsors are being taken to task for not acting in participants' best interests. In *Tussey v. ABB*, the U.S. District Court of Western Missouri found that ABB, a provider of power generation systems, chose high-cost investments, failed to properly renegotiate recordkeeping revenues and failed to monitor the plan properly.

"Anyone who is working on a company's retirement plan has to check their corporate obligation at the door and focus entirely on that," says Blaine Aikin, CEO of fi360, a Pittsburgh firm that trains advisors in the fiduciary standard. "They have to serve the best interest of their participants."

That's not how it gets played out, however. According to the Unified Trust 2009-2010 survey of plan sponsors, 53% did not consider themselves fiduciaries. The threat of lawsuits is likely to drive more employers into the arms of RIAs who can act as the "prudent expert," in fiduciary parlance.

The principals in these small companies and nonprofits "have a huge legal liability, and it's something we as RIAs can provide them a safe harbor from," explains Harold Evensky, co-founder of Evensky & Katz, a wealth management firm with offices in Coral Gables, Fla., and Lubbock, Texas, that has a handful of 401(k) relationships.

STARTING SMALL

Larger plans have been mostly picked over by dedicated retirement specialists, says Cerulli analyst Kevin Chisholm, referring to advisors whose retirement business represents more than 40% of their revenues. "It's no longer an easy opportunity," Chisholm says. "There are a lot of people out there who have the expertise and they're going to have a much better value proposition than an RIA that's just half in the business."

However, there's opportunity in the $1 million to $10 million plan market, Chisholm says. "Ninety-one percent of all 401(k) plans" — a defined contribution marketplace that adds up to about $3 trillion — "have less than $5 million," he says. "And those are just the companies with plans. There are a lot of small businesses out there that don't have plans right now, and that's a completely untapped market."

You don't have to persuade Doug Orifice, an LPL advisor and founder of South Shore Financial Consultants in Weymouth, Mass. He deals with companies with 25 or fewer employees; the plans he works with range from a startup with just a trickle of new deposits to a $2 million plan.

When he went independent, he says, he decided to only deal with the smallest plans. "When I was at Bank of America, I had one big plan with 250 employees scattered around the country," he recalls. "I'm sticking with the smaller companies and smaller employee populations. At these companies you're not dealing with a CFO because a smaller business does not

have one, so it makes the layers of decision-making easier." He wants to grow the retirement plan business, but only by one plan a quarter or so.

Evensky agrees: "That's the sweet spot, because there's little or no good quality competition, and that's where I think we can be incredibly competitive."

DIFFERENT MODELS

At the other end of the spectrum is someone like Mike Francis of Pewaukee, Wis. In 1988, he was a retail broker with a wirehouse when a client, a co-owner of a business, wanted help starting one of the new 401(k) plans he was reading about. "This was an important client and I wanted to make sure he got good service," Francis says.

He did the research and then went on the road with his client to communicate the new employee benefit to the firm's 700 workers. He found that he liked dealing with retirement plans, and wanted to develop expert knowledge in the area. In the mid-1990s, he enrolled at Marquette University's law school to focus on benefits law and ERISA issues.

In 2004, he founded Francis Investment Counsel, a firm that oversees mid-size and large 401(k) plans. He no longer does any wealth management because he worries that, as a fiduciary, his advice might be perceived as tainted if he's also soliciting wealth management business. He also wants to avoid exposing clients to potential legal wrangles, he says, should a former employee feel they got bad advice on a rollover.

In fact, he says, several years ago, he got a call from a former employee of a company Francis' firm had advised. The man wanted to roll over his 401(k) – by then worth several million dollars – to Francis' firm, because he had enjoyed working with him. "We had to tell him no," Francis says. "To the extent that you are providing advice to employees, you cannot give any advice that benefits you."

Other advisors work the fiduciary angle in another way. They do not become full 3(21) fiduciaries – so named after an ERISA provision – and assume the full scope of fiduciary duty. That would require them to take the role of the plan sponsor, hiring and monitoring all the service providers in the plan. Instead, they become 3(38) fiduciaries – essentially investment managers – taking on responsibility for the investment selection and monitoring those investments.

Although the plan sponsor is still responsible for choosing and monitoring the investment manager, the sponsor is relieved of the responsibility of the actual investment decisions. And RIAs can hire a 3(21) fiduciary service to work alongside them in order to outsource the top layer of fiduciary duty.

"The duties of a 3(21) are to know the regulatory environment, and that's not our core business," says Todd Douds, director of operations of Fort Pitt Capital Partners in Pittsburgh.

As 3(38) fiduciaries, many advisors feel more comfortable pursuing wealth management relationships with the employees they meet. "I would advise RIAs not to assume fiduciary responsibility," Francis says.

'IT OPENS OTHER DOORS'

For Fattibene, the detour into managing retirement plans has already yielded dividends. When conducting participant education for clients' plans, he says, "We go in and we give very specific advice." A handful of employees want Fattibene to then oversee their entire portfolios.

"Maybe a participant doesn't have a very large 401(k) balance," Clarke says, "but they have a spouse who is a professional in the community who has a lot of money. It opens other doors."

There are ways to make retirement plans more attractive to the advisor. CLS Investments, with $1 billion in assets under management, representing more than 1,000 plans, has built risk-based model portfolios for participants – and can replicate those portfolios across the plans. "For us, it's been a fantastic way to grow the business," Clarke says.

Likewise, Fort Pitt recently came out with a product for its retirement clients as a way to build that side of the business, which is now less than 10% of its $1.4 billion in assets under management. "We can manage our asset allocation models at the global level," Douds says. "Through the technology, we get economies of scale."

For the advisor who is willing to put in the work to get up to speed on retirement issues, even small and micro-plans offer an opportunity. "It seems like it should be an easy sale," Evensky says. For clients, he explains, a retirement plan is "something you have to do, and you're overpaying for it and you have a personal liability that we can protect you from." **FP**

MOST RIAs WHO WORK WITH 401(k)s SAY THEY STARTED WHEN A SMALL BUSINESS OWNER APPROACHED THEM FOR HELP CREATING OR MANAGING A COMPANY PLAN.

Ilana Polyak, a *Financial Planning* contributing writer in Northampton, Mass., has also written for *The New York Times*, *Money* and *Kiplinger's*.

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