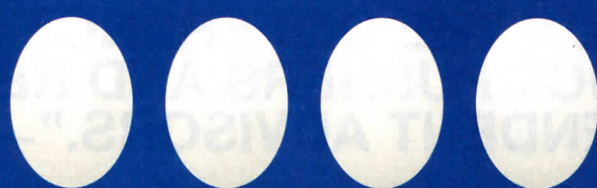
DAY OF RECKONING



FEE-BASED ADVISORS SHOULD BENEFIT WHEN 401(K) PARTICIPANTS SOON FIND OUT THE COST OF THEIR PLANS.

BY MICHAEL J. McDERMOTT

Almost invariably, change in any business brings with it a new set of challenges, and that's certainly true of the new fee disclosure regulations scheduled to take effect in July. The flip side of change, however, is that it also creates golden opportunities—for those astute enough to spot them and agile enough to act on them. Opinions vary across the board about just what impact fee disclosure will have on the industry, but at least some advisors view it as a chance to burnish their image and make client welfare the primary goal.

The big winners will be fee-based advisors, predicts Rick Tonkinson, CFP, the president of Miami-based Tonkinson Financial, a practice focused on working people and their families. "The new fee-disclosure requirements are going to cast a bright light on the difference between product pushers and real independent advisors," he opines.

Part of the reason is because plan participants don't currently see how they are being charged. "There is a widespread perception among working people that the 401(k) is a free lunch, because they don't see fees itemized as deductions from their paychecks. I think this will be a wakeup call that will energize and motivate many of them to begin shopping around, maybe consider doing an in-service withdrawal that they roll over into an IRA, where they can get real objective advice and research."

Tonkinson, who's been proselytizing for greater transparency in fee disclosure for many years, manages more than $210 million, much of it in retirement funds from Florida Power & Light Co. employees. He points out that the average mutual fund fee is 1.6%, according to Morningstar, and that some financial services firms have been charging as much as 3.5% in fees on group annuities, (though most have ratcheted those fees down in anticipation of the disclosure regulations).

His firm charges a flat 1% management fee, with no additional cost to get in or out of funds. Tonkinson keeps a tight rein on overhead, spending just 15 cents on the dollar in an industry where the average break-even point is 40 cents. "I am hoping that small investors get upset when they realize what they have been paying in fees all along," he says. If that happens, he believes, firms like his stand to benefit from a big increase in new business.

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Tonkinson's argument makes a lot of sense, and the success he's had with his practice demonstrates the viability of the low-fee, highly transparent business model he's embraced for many years. But some industry participants see a range of other possibilities flowing from the new disclosure rules. "We applaud transparency, and we applaud low fees for value," says David Musto, the CEO of J.P. Morgan Retirement Plan Services LLC, "but I think the market is sort of missing the point—and the opportunity."

In the middle, large and mega-segments of the retirement plan market, the vast majority of sponsors are already being assisted by some kind of retirement advisor or consultant, Musto points out. The appetite for cost-effective programs is not a new phenomenon suddenly springing from fee disclosure or transparency.

"This process has been under way in our marketplace for the better part of a decade," he says. "I think where folks missed the point—and the opportunity—is that it's not just about fees. When you think about the diversity of plan design and the different types of customized communications and investment alternatives being used across programs, it's not as simple as just looking at fees and comparing them to some industry average."

Instead, Musto proposes, advisors can get ahead by educating plan sponsors and helping them design benchmarking processes that compare apples to apples. When comparing against averages, inevitably, some plans are going to stand out as being "crazy expensive," he notes, but those plans often have a more complicated design that does more things for participants and perhaps facilitates better results. "I would view that as a good thing, not a bad thing," he says. "I think the best retirement advisors get it, but I think others are missing the boat here."

He argues that there are areas in the new rules where the best advisors are really positioned both to help clients and be successful themselves. One is benchmarking their fees and value against plans of similar design.

Next, advisors can help sponsors re-evaluate their plan designs, with an eye toward eliminating costly features and components that ultimately deliver very little value to the organization and plan participants. He cites features such as complex match formulas, certain compliance processes, top-heavy testing for very small plans and lengthy custom notifications about compliance for individual participants. These are areas where advisors might be able to help plan sponsors save money, streamline procedures and improve performance, he says.

Another thing would be complex payroll submissions. "Some organizations have very inefficient payroll process, so they end up submitting redundant data or inefficient file formats that result in their being charged higher fees by recordkeepers and administrators," Musto says.

Advisors who roll up their sleeves and help clients conduct an intelligent and thorough review of their plan design can increase their standing and value in the eyes of those clients. "Creating efficiency has a positive impact on fees for the plan sponsor and participants, freeing up resources that can be focused on areas that are actually going to drive better income replacement rates for participants," he suggests.

Advisors can also help sponsors make their plan results more specific and transparent. Traditionally, the industry has focused on statistics such as average deferral rates, contribution rates and portfolio diversification, using that data, on a relative basis, to assess how well a plan is working for its participants. But that approach oversimplifies the factors that ultimately lead to better income-replacement rates for participants, Musto argues. "Where the focus and the dialogue really need to start is by looking at those replacement rates," he insists.

J.P. Morgan Retirement Plan Services has been an innovator in the marketplace, providing those income replacement rates to its advisor partners, clients and plan participants for the better part of a decade, Musto says. "What we've found is that the more sponsors and participants are exposed to that information—through Web sites, statements and targeted communications—the more engaged participants become in saving more and investing more wisely in their program, and the more impactful sponsors become in tailoring their plan designs in ways that increase or improve those results," he says.

Paul Mahan, director of retirement consulting services at Commonwealth Financial Network, says fee disclosure will likely offer advisors and broker-dealers the ability to grow and retain more assets, as more prolific revenue results from greater AUM. "Plan sponsors and their benefit-eligible employees place their trust with a partner and an expert," he says. "In this particular case, it is the advisor that's overseeing and managing—operative word, 'managing'—a retirement plan. The market's definitely going to move toward those advisors that have the tools and the expertise to measure, manage and grow these workplace benefits."

In addition, fee disclosure will allow the industry as a whole to refine and standardize reporting for the first time ever, Mahan adds. Such a data landscape would help plan sponsors, advisors and broker-dealers do a better job of identifying both the strengths and shortcomings of existing plans. "It would provide a more dynamic environment to handle problems and give us an opportunity and the tools to craft a strategy based on what we see regularly, and then to continue building on that," he says.

Lon Henderson, president and CEO of Soltis Investment Advisors in St. George, Utah, says advisors will be able to strengthen their bonds with plan sponsor clients by helping them define "reasonable" service-provider compensation. Advisors best-positioned to benefit will be those who have already adopted a highly transparent business model, particularly fee-only firms, he says.

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Kim Anderson, vice president of retirement services at Soltis, points out that transparency has always been the core of the firm's money management model. The firm's vision statement is to create, build and manage wealth so its clients are "free to pursue life's most important endeavors," and that requires a high level of confidence on their clients' part. "The more knowledge and transparency we can provide our clients, the more we educate them about what things actually cost, the greater their level of confidence in us becomes," he says. "That's always been our approach, so we are proactively well-positioned to seize opportunities resulting from the new fee-disclosure requirements."

Many different variables, ranging from plan size and design to an advisory firm's business model and compensation structure, will play a role in the opportunities fee disclosure spawns for the industry. The most important thing, says Steve Dufault, a senior consultant at DiMeo Schneider in Chicago, is for advisors to "open their arms up to fee disclosure and recognize that it's a good thing. Having both plan sponsors and participants understand the fees they're paying—and, more importantly, understand who's getting paid what—is important. Advisors who embrace this approach will ultimately benefit from more intimate relationships with their clients." FA