Selecting and Monitoring Fiduciary Advisors

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Effective December 27, 2011, the Department of Labor's Employee Benefits Security Administration (EBSA) issued its final rule regarding the provision of investment advice to participants in individual account plans, such as 401(k) and 403(b) plans, and beneficiaries of individual retirement accounts. The final rule affects plan sponsors, fiduciaries, participants, and beneficiaries of participant-directed retirement plans. Essentially, the rule enables providers of investment advice acting as fiduciary advisors to offer investment guidance to participants provided certain conditions set forth in the regulations are satisfied.

The Need for Advice

Recent studies have indicated that participants who receive professional investment advice consistently outperform those who go it alone. Constructing a proper asset allocation is key to the long-term success of any retirement strategy and most participants are ill-equipped to make such a potentially life-altering decision on their own. The DOL's new participant investment advice regulation attempts to offer participants another means of achieving their retirement goals.

Not all investment advice that has been provided in the past has been impartial or in the participant’s best interest. Sometimes there have been conflicts of interest unknown to the plan sponsor. In selecting a fiduciary advisor the plan sponsor still retains fiduciary responsibility in selecting the form of investment advice they offer to their participants.

Best Fit

There are numerous factors to consider when selecting a fiduciary advisor to a plan. The last few years have seen dramatic growth in the independent investment consulting industry and with the passage of the new regulation, more solutions are sure to follow. The first step is to determine what type of investment advisory service is the best fit for the plan participants.

Traditionally, plans have relied on an eligible investment advice arrangement ("EIAA") through a fiduciary advisor to help employees make informed investment decisions, but this is no longer the only available option.

Third-Party Advice

Web-based investment guidance services and managed accounts offered through an independent, third party are increasingly popular options. These firms are unaffiliated with any of the plan’s fund providers or managers. According to the new regulation, their methodology for building an asset allocation must not be in any way impacted by the funds selected. In other words, they must not have a vested interest in or receive any additional financial benefit from using one fund over another. The methodology must be fund and share class neutral. In order to determine the best option for their participants, plan sponsors should conduct a thorough analysis based on their company's demographics and plan objectives.

Identifying Fiduciaries

Another important factor which is often overlooked in selecting a fiduciary advisor is determining exactly who can act as a fiduciary advisor. Many brokers may offer investment advice to participants but most are protected by regulations from taking on fiduciary liability. In many cases, if the advisor is not receiving compensation directly from the act of offering advice, they are not considered a fiduciary under the current law.

Eligible fiduciaries generally come in four categories: a registered investment advisor (RIA), an advisor for a bank providing services through the trust department, an insurance company representative and a representative of a registered broker-dealer. Plan sponsors should check with the fiduciary advisor to confirm their status as an eligible fiduciary to the plan and receive confirmation in writing that they are acting as a fiduciary.

Establish Evaluation Criteria

The next step in selecting a fiduciary advisor is for the plan sponsor to establish objective criteria for evaluating an advisor that fits the needs of its participants. The retirement plan committee is responsible for creating a documented checklist that can then be used to evaluate fiduciary advisors. Some general criteria should focus on identifying any potential conflicts of interest, fee and compensation arrangements that may cause the advisor to pressure participants into less appropriate products. The firm's experience and depth of services in providing fiduciary advice and specifically the qualifications of the professionals providing the advice are important. Checking for any disciplinary actions against the fiduciary advisor or the firm should be conducted at the onset and on an annual basis for any potential change in status.

The fiduciary advisor's professional credentials and investment experience are critical. Many large firms may be impressive marquee names yet the individuals providing the advice may be junior, less skilled advisors than small boutique firms whose advisors may be highly experienced professionals providing high caliber advice.

Ongoing Monitoring

Once a suitable fiduciary advisor has been selected, it is important that the sponsor establish a process for ongoing monitoring of the advisor. Best practices dictate that a plan sponsor review their plan's fiduciary advisor at least once a year. There are a multitude of factors to consider, but a prudent approach would include a deep dive of the advisor and documenting their process. This would include confirming that all required documentation and notifications were provided.

Another factor to consider would be determining whether the advisor is actually complying with the new participant investment advice regulation.

Revisiting the relative cost of the investment advice program in relation to participant adoption and utilization is a prudent way to quantify the value added by the fiduciary advisor. If participant adoption is relatively low compared to the cost, perhaps more education is required or the plan sponsor may want to scale back on the services offered .

A thorough review should also include inquiring into and following up with participant comments and feedback. Any participant complaints should be addressed immediately. Participant feedback, whether positive or negative is a good way to stay ahead of any potential fiduciary liability issues. Fine-tuning the plan based on participant comments may lead to increased participation rates, if done in a prudent way. Updating the firm's and fiduciary advisor's status for any disciplinary actions should be part of the annual evaluation.

The most important fiduciary benefit of conducting this due diligence review is documenting the decision making process and the results. Comprehensive documentation of the information collected to render decisions that impact the plan is the best way to protect the plan sponsor from fiduciary liability. While investment returns may go up and down, a detailed accounting of the due diligence process is the plan sponsors' greatest asset. An annual review of the plan's fiduciary advisor will go a long way to fulfilling a plan sponsor's fiduciary duty.

Conclusion

Most participants lack the skill, training or time to construct a disciplined, asset allocated, long-term investment strategy. Short-term trends often lead them to make mistakes and risk their long-term success. Individual investors are driven by emotion, causing them to make the same investment mistakes over and over. The DOL's new participant investment advice regulation attempts to offer participants another means of achieving their retirement goals. Plan fiduciaries are responsible for evaluating and understanding the advice options they offer to their participants. Realizing the plan sponsor's role in delivering this essential service is an important fiduciary duty.

Establishing a defined strategy for implementing participant investment advice is key to fulfilling a plan sponsor's fiduciary obligations.

