

*Has “Independent” Lost Its Meaning? – Maybe, But Not For Long.*

*By, Attila Thomas Toth*

*Principal – Portfolio Evaluations, Inc.*

Although fiduciary responsibility was always something to take seriously, the responsibilities falling on a plan sponsor have never been more complicated and challenging than they are today. With the recent passage of the Pension Protection Act of 2006, plan sponsors have been surrounded by several new issues, including automatic enrollment, automatic deferral increases, QDIA, accurately monitoring target date funds, employer stock diversification, Roth features and fee benchmarking. In today’s complex environment, more and more plan sponsors of all sizes are reaching out for guidance to help them understand and comply with the new rules. Many plan fiduciaries are seeking the assistance of outside legal counsel as well as an “Independent” Consultant. According to the Profit Sharing/401(k) Council of America, 64% of all plans in its survey retain an independent investment adviser to assist with their fiduciary responsibility.

Due to this tremendous interest, more and more advisers are opening their doors. Commission based advisers that are new to the industry, as well as those which historically focused on servicing wealthy individuals, are tactfully advertising their “independence” on websites, brochures and in sales presentations. Without knowing any better, many plan sponsors retain these professionals to only realize later that “independent” was not really independent. Advice that was thought to be in the sole interest of the plan’s participants and beneficiaries was actually for the best interest of the adviser.

Years ago, “independent” stood for something. It stood for conflict free, unbiased and objective advice. No revenue sharing or soft dollars were paid. No commissions were paid for placing money with a specific fund company. The consultant “adviser” was not

owned by a large financial institution which also happens to own or be a broker dealer. Back in the 90's, several consultants realized that a "Chinese wall" was not strong enough to support two business lines, one which created a conflict and one which pretended it didn't, so they sold their consulting businesses.

When an adviser, an affiliate, or its owner receive anything other than 100% of its revenue from a fee for service structure, they are not truly independent and should not be able to use the word "independent" in their marketing materials. Many advisers are paid commissions, profit sharing contributions, and creative incentives from mutual fund companies for recommending their funds. Unfortunately, in today's world, there are no rules or requirements to disclose this conflict of interest, so it often goes unnoticed.

Hopefully, the rules permitting these conflicts to go undisclosed are about to change. The U.S. Department of Labor's (DOL) new proposed regulation under ERISA Section 408(b)(2) mandating disclosures of compensation (direct and indirect) and conflicts of interest by plan providers would expose many advisers. The impact of the proposed regulation would be enormous. It will require every investment and financial adviser to have a written contract with all of its clients explaining the services being provided, providing extensive disclosures about their direct and indirect revenues, and disclosing any potential conflicts of interest. Many in the consulting industry that are truly independent anxiously await the passage of this regulation so plan sponsors will be able to identify these conflicts and "independent" can truly mean "independent."

To determine if your adviser may have a potential conflict of interest and may not be truly independent, here are some warning signs to look for:

- 1) Your plan is receiving consulting services for free.

*Some advisers are willing to work for "free" because they receive more than enough hidden compensation.*

- 2) Your consultant is a broker dealer or owned by one.

*The definition of a broker dealer is: "Any individual or firm in the business of buying and selling securities for itself and others." These organizations are paid commissions for selling securities to you.*

- 3) Your consultant's website states "member SIPC" or "securities offered" in small print on the bottom of their website or on their wealth management business website.

*To protect shareholders, Securities Investor Protection Corporation (SIPC) is the first line of defense in the event a brokerage firm fails to pay customers for any cash or securities that are missing from their accounts. Once again, this is a sign that your adviser sells securities and is commissioned to do so. Many advisers hide the fact that they sell securities.*

- 4) Your consultant consistently recommends specific fund companies, generally insurance related products.

*Almost all investment funds provide a creative compensation structure for their distributors. Since insurance products are among the highest in payouts, they are attractive to this kind of adviser.*

- 5) Your plan uses share classes that begin or end with A, B, R or Adviser.

*These share classes are generally the ones which pay the adviser.*

- 6) Your consultant is being paid from an ERISA budget or a plan expense budget.

*ERISA budgets and plan expense credits have become fairly popular. In most cases they are negotiated with the record keeper. This budget is a great way for the adviser to hide or bury commissions.*

When these concerns exist, the plan's cost structure often includes excessive fees ranging from hundreds of thousands to several millions of dollars. If you suspect your adviser may have a conflict of interest because of the presence of any of these warning signs, you may want to consider speaking with an organization which understands the mechanics of hidden compensation and is truly independent.

*Portfolio Evaluations, Inc. is a truly independent, fee-based consulting firm. With offices across the country, it is one of the largest national consulting firms today.*