THE NORTH PIERspective

Fiduciary Commentary

Spring 2014

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By: Brant Griffin - May 05, 2014

Changing Landscape of Plan Service Providers

Developing trends in the retirement plan industry are solidifying to have a lasting impact on industry economics. This changing landscape is led by regulatory initiatives focusing on protecting investor interests from long-standing, but profitable industry practices of recordkeepers marketing financial products to the participants they serve. The scrutiny has driven many industry players to reevaluate their place in the market and potentially force a choice between serving as an institutionally-centered recordkeeper and focusing on the retail marketplace, selling broader financial products.

Recordkeeping is a mature market with operators surviving on razor-thin profit margins. In years past, many organizations made strategic decisions to participate in this business believing that profitability would be maintained, and eventually enhanced by driving rollover assets to their higher margin retail businesses. Plan service providers viewed these entrenched and endorsed positions as a valuable conduit to capture participant savings as employees would cycle through multiple employers over their careers.

Recently enacted ERISA Section 408(b)(2) has indirectly pressured service providers to lower fees. The 2012 law requires all covered service providers to disclose all fees and sources of revenue generated from plans, along with any potential conflicts of interest making inefficiently priced plans easy targets for competitors. The effect has been additional compression on provider's revenue and catapulted several conflicted business practices to the forefront of regulator's agenda. Additionally, future DOL involvement in the IRA rollover process and its possible inclusion as a fiduciary act will further alter industry practices and test service provider's resolve in the marketplace.

Increased Regulatory Oversight

Recently, there has been an increase in regulatory scrutiny to these long-standing practices in the financial services industry. Industry regulators FINRA and the SEC recently identified their 2014 examination priorities highlighting the industry practices surrounding rollover distribution services from employer plans as problematic. Additionally, FINRA Notice 13-45 (issued in late 2013), provided guidance to the brokerage industry on its responsibilities and conduct when providing IRA rollover services.

Much of this recent regulatory attention can be attributed to March 2013's 401(k) Plans investigation by Congressional watchdog the Government Accountability Office (GAO). This report found that many retirement plan providers gave misleading (or even false) information to participants they served in hopes of acquiring rollover assets. As a result of their findings, the GAO urged the DOL and IRS to formulate rules to protect the interest of investors in the rollover process. The GAO has called for stronger consumer protections that would prohibit deceptive and misleading IRA marketing materials and require the standardization and full disclosure of IRA fees.

Fiduciary Concerns

IRA Rollovers, which represent more than 90% of the contributions to the over $6 trillion IRA market, are big business for Wall Street. As a result, the financial services industry vigorously markets its investment services and IRA products to this market. Retail branded investment firms like Schwab, Fidelity and others that possess strong consumer marketing capabilities with hundreds of physical locations are well positioned to sell retail financial services.

Increasingly, plan sponsors (and their consultants) feel compelled to review their service provider's practices and employee communications as part of their fiduciary process. This elevated fiduciary sensitivity is due to the perception that an organization's recordkeeper is often viewed as the employer's endorsed provider and may unfairly leverage their position to push its financial products. As a result, some organizations have shielded their employees from solicitations by forbidding providers from positioning rollover and other financial services.

In an almost unimaginable move, Charles Schwab recently announced that it was terminating its recordkeeping arrangements with several large 401(k) clients totaling $25 billion in assets after they declined to allow the retail brokerage giant any contact with their plan's participants. With this move Schwab is stating its willingness to walk away from its entire recordkeeping book it purchased from the 401(k) Company in 2007 for $115 million. Schwab has made a bold statement about its position in the industry and highlights the dramatic shifts underway.

Great West's acquisition of JP Morgan's recordkeeping division and it's combination with Putnam's recordkeeping group signals that companies are jockeying to identify their core competencies in this ever evolving market. As these trends develop further, this changing landscape will undoubtedly cause other organizations to question their role in the industry and eventually either alter their practices or exit the space altogether.

Conclusion:

So, what about the interests' of participants? Many claim that providing rollover services is a valuable resource to employees. But North Pier feels that current industry norms should not be relied upon as a template for what is the best for participants. Why is distributing savings from an employer plan at retirement automatically considered the right thing to do? Increasingly, I believe that greater emphasis should be placed on maintaining employee savings in the plan beyond retirement. With thorough attention now on investments and their fees, along with the burden of responsibilities on plan fiduciaries to monitor them, staying with a well designed plan is often the best environment for a retiree's savings. For those that feel compelled to rollover their retirement nest egg, options should only be proposed to employees with tightly defined fiduciary rules in order to protect investors from bad advice.

The financial services industry's IRA rollover practices have become of increasing concern to regulators as assets held in IRA accounts represent the largest percentage of all U.S. retirement funds and the bulk of retirees' wealth. The mere size of this market magnifies the importance and effects of decisions service providers will make concerning the regulations ahead. With the ever continuing aging baby boomers, this issue will only grow in importance in the years ahead.

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