



MOAT BUILDING:

Using the **CE_{EX}** SPDR to evaluate
and document fee reasonableness

Joseph M. Gordon, Partner

CFP[®], CIMA[®], AIFA[®]

GORDON ASSET MANAGEMENT, LLC

WWW.WEALTHQB.COM

I. WHERE ARE WE NOW?

408(b)(2), a year in retrospect...

- How has the market place changed?
 - Large vs. Small plans
- Are stewards/RPFs confident they are exercising their responsibility properly?
- What are common documentation practices? Benchmarking? RFPs?

I. WHERE ARE WE NOW? (cont.)

- Is transparency working? Do RPFs truly understand their role?
- Are the disclosures simple, clear, and easy to understand?
- Is plan sponsor decision making changing? In what way?

...a race to the bottom?!

I. WHERE ARE WE NOW? (cont.)

The emperor wears no clothes!!!

- Are the regulators pleased with initial findings?
- Can most RPFs articulate whether their plan's fees are reasonable for the services provided?

I. WHERE ARE WE NOW? (cont.)

Who's feeling the impact?

- Record keepers (bundled or unbundled): fund company, broker-dealer, or insurance company
- TPAs
- Non-fiduciary advisors (brokers/FAs) including group annuity sales
- Fiduciary advisers (RIAs)
- Trust Companies (discretionary or passive directed)

II. OUR EXPERIENCE

Things we're seeing

- Fee compression:
 - The common cold call: “your fees are way too high, and we can lower them”
- Small plan stewards are clueless:
 - Most outsource while large plan stewards are actively reviewing their arrangements
- Stewards are generally unaware of their responsibilities under the regulation:
 - “We assumed you were taking care of this...”

II. OUR EXPERIENCE (cont.)

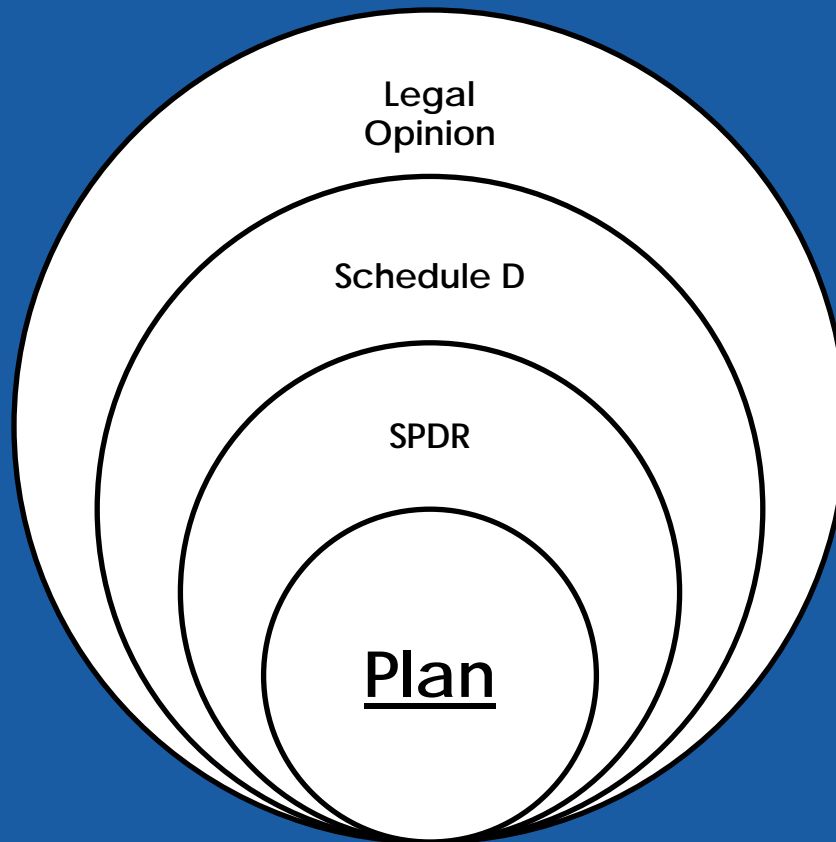
- Is benchmarking becoming the holy grail?
- Disclosures are not uniform:
 - Some are short and clear
 - Others throw in the “corporate counsel kitchen sink”
 - NOTE: DOL 2013 regulatory agenda initiative to homogenize disclosures
- 2012 ASPPA annual conference comments:
 - DOL field auditors gathering disclosures as part of 2009-10 plan audits

II. OUR EXPERIENCE (cont.)

- Little uniformity in how things are being done.
 - During a recent review of audited plans, we found that 5500 Sch C's were completed differently, and there was little mention of revenue sharing, even when it is an ERISA bucket inside the plan
- Marketplace observations:
 - pricing pressure on recordkeepers
 - brokers trying to get B/D permission to work in the 401(k) space
 - some experience requirement; blind squirrels going away or getting boot camp training somewhere

ENTER THE SPDR

The CEFEX sponsored
Service Provider Disclosure Review



III. ENTER THE SPDR

- Assessment performed by FI360 trained AIFA ("Analyst") brings independence and no hidden agenda
- Ideal for Plan Stewards/RPFs who lack the time, resources, training, and skill necessary to document fee "reasonableness"
- RPF must understand their responsibility to affirm "reasonableness" to make the commitment to the process

III. ENTER THE SPDR (cont.)

- RPFs come from 2 camps
 - those who **know** they don't know
 - those who **don't know** that they don't know
- Pitfalls:
 - Selling the engagement when already CEFEX certified (i.e. "we thought we were already taken care of")
 - Plan Sponsor's general unawareness of the regulation requirement
- Additional motivator: SPDR fee is deductible as a plan expense

IF NOT SPDR, THEN WHAT?

Benchmarking?

RFPs every 2-3 years?

Nothing?



IV. IF NOT SPDR, THEN WHAT?

Benchmarking: the be-all end-all solution?

- Easier for quantitatively measured services such as:
 - Trustee services, record keeping, etc.
- Much more difficult to assess:
 - Quality and experience of TPA compliance knowledge
 - Adviser competence and experience

IV. IF NOT SPDR, THEN WHAT? (cont.)

Common Benchmarking Limitations

“garbage in, garbage out”

- Limited data for certain size/segment of plans
- Large asset bands for comparison
 - Plans at lower end of band seem expensive and larger plans cheaper at the top end of the band
- Quantitative checklist of services
 - Just “checking the box” provides no measure of the scope, depth, and quality of services

IV. IF NOT SPDR, THEN WHAT? (cont.)

Common Benchmarking Limitations (cont.):

- In many benchmarking databases, “advisers” appear identical
 - analogy: 1990s composite separate account performance in investment consultant databases; numbers reported by firm; trusted, but not verified
- Flawed scoring systems
 - giving a plan menu an aggregate Sharpe ratio or building a bias that lowest cost always wins (passive rules because the only guaranteed alpha is low fees!)

“DEBUGGING” THE SPDR

Our pilot program to debug the SPDR for commercial acceptance as the best practice to test the “reasonableness” of fees for the value of services provided.

V. DEBUGGING THE SPDR

- Our firm; 100 daily 401(k) clients (80+ are small plans), primarily medical and professional service firms
- To date, 35 have signed the engagement and completed the certification; about 10 said no for reasons previously cited
- As an SEC registered RIA, there is an inherent conflict of interest if we were to analyze our own services/fees.
 - As a result, independent analyst, Mario Giganti AIFA, was engaged to assess our firm's role as a fiduciary/investment advisor

V. DEBUGGING THE SPDR (cont.)

- Documents used:
 - SPDR
 - CAFÉ Schedule D
 - 3rd party benchmarking reports
- Methodology:
 - Clients banded based on plan asset size
 - Each band was benchmarked
 - If within any band, fees were in the 50th percentile or lower, no CAFÉ D needed
 - If above the 50th percentile, but within 25%, CAFÉ D needed to document the additional services to test reasonableness

V. DEBUGGING THE SPDR (cont.)

- Methodology (cont.):
 - Sampling method used on adviser as firm is CEFEX certified as an investment adviser
 - If plan service provider not CEFEX certified, then likely every engagement must have plan benchmarking
 - Best practice: even if plan fees are at 50th percentile or lower, the CAFÉ Schedule D provides further evidence as to the value of services provided, enhancing the value proposition of the service provider

V. DEBUGGING THE SPDR (cont.)

SPDR

- 22 questions detailing evidence of compliance with disclosure regulations with Q21 requiring affirmation from steward of “reasonable and necessary” fees
- Registered Opinion Letter from CEFEX to steward at conclusion
- CEFEX certification to law firm to issue “legal opinion”

CAFÉ Schedule D

- 4 questions helping to establish fee reasonableness with “Qualitative” service considerations checklist focused on credentialing, experience, training, and processes used to deliver the services provided
- It’s not just what you say you do...
 - It’s what you *actually* do, when you do it, how and why you do it, and how it is done uniformly across a broad cross-section (sampling) of your clients

VI. IMPROVING THE SPDR

Areas for Improvement

- Time expended
 - cannot do assessment at a loss and make it on volume, a la Amazon.com
- Need additional checklists to guide assessment
 - Example: identifying Covered Service Providers
- Reviewing agreements vs. services performed
 - Annual notices for QDIA, auto enrollment, safe harbors, and 404a-5 participant fee disclosure
 - conundrum for a recordkeeper and non-fiduciary helping prepare 404 a-5 notices, a fiduciary function of the steward/RPF

VI. IMPROVING THE SPDR (CONT.)

SPDR: the industry standard

- Less “RFP like” questions for recordkeeper/TPA
 - Questions should focus on the qualitative aspects like education, experience, and quality assurance
- Personal goal:
 - Make SPDR an open source collaborative “best practice” process of AIFAs and other industry professionals
- Client deliverables
 - Letter from analyst that assessment is complete, with negative consent to findings of reasonableness
 - Client reports available on request, electronically or otherwise

VII. OPPORTUNITIES

- Become the AIFA SPDR professional for non-client plan stewards/RPFs
 - Market through advisers in the “K” space locally
 - Other AIFs with blocks of business
 - Trust company/bank blocks of business
 - Plan auditors/accountants
 - ERISA legal
 - Broker-dealers (an insurance policy of sorts)

VIII. CONCLUSION

Prevention is the key

The DC regulatory “smack-down” is causing plan sponsors and plan professionals to become increasingly aware that an ounce of prevention is worth more than a pound of cure.

VIII. CONCLUSION (cont.)

By outsourcing the responsibility to document fee reasonableness to an independent 3rd party analyst working with the CEFEX SPDR, plan stewards can find peace of mind through effectively building a moat of protection around their plan for a very reasonable price.

VIII. CONCLUSION (cont.)

A personal story

- A medical practice manager with 15 physician partners and 300 employees:
 - “My doctors each have a friend/broker who guarantees our fees are too high”
- After spending 4-5 hours researching, it became clear that documenting fee reasonableness is very difficult
- The SPDR now serves as tangible evidence that their fees are reasonable
- All have moved on...no issues