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Retirement Plan Advisor Business Models

"How to Take Advantage of the Coming Golden Age for Independent Investment Advisors in the Retirement Plan Marketplace"

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Session Outline

- Step One – Examine your current business model
- Step Two – Review retirement plan business models
- Step Three – Determine which business model is best for you
- Step Four – Implement your business model

Step One – Examine

- What is your current licensing situation?
  - Broker/Dealer (B/D)
  - Registered Investment Advisor (RIA)
  - Dually Registered (Hybrid, B/D-RIA)

Step One – Examine

- If you are affiliated with a Broker/Dealer:
  - The B/D's stance on advisors working with retirement plans
  - The B/D's position on advisors accepting fiduciary status
  - Does the RIA offer only a limited access to retirement plan vendors (recordkeepers)
    - Preferred list
    - Open architecture
  - Identify what conflicts of interest exist in your particular situation

Step One – Examine

- If you are affiliated with an RIA:
  - The RIA’s stance on advisors working with retirement plans
  - The RIA’s position on advisors accepting fiduciary status [3(21), 3(38)]
  - Does the RIA offer only a limited access to retirement plan vendors (recordkeepers)
    - Preferred list
    - Open architecture
  - Identify what conflicts of interest exist in your particular situation

Step One – Examine

- What kind of retirement plan experience and knowledge do you possess?
  - Do you have a working knowledge of ERISA?
  - Do you have a clear understanding of Department of Labor (DOL) and Internal Revenue Service (IRS) mandates relating to qualified plans?
  - Do you possess a thorough understanding of the prohibited transactions rule and related case law?

Step One – Examine

- What kind of experience do you have:
  - Managing relationships with Company Boards, Investment Committees, trustees, Named Fiduciaries and other Plan Fiduciaries
  - Working with outside ERISA Counsel
  - Working with Corporate Legal Counsel
  - Working with Recordkeepers, Custodians, TPAs
  - Managing and documenting a prudent investment process that will withstand rigorous outside review
  - Servicing plan participants in an efficient and effective manner

Step One – Examine

- What kind of time constraints or limitations do you have?

- What kind of services do you currently offer or want to offer to retirement plans?
  - Plan level advice
  - Participant level advice
  - Advice at both levels
  - Rollover services
  - Other Participant services

Step Two – What are the Various Business Models Available to Financial Professionals?

- Parameters
  - The following business models are described in relation to offering services to qualified retirement plans (to the PLAN)
  - These business models identified are the beginning of a conversation and probably do not represent every potential business model available
  - The following business models are structured in relation to the existing rules and regulations currently in existence (April 2010)
  - Changes in regulations, case law or legal precedents may have a material effect on any business model identified in this presentation

The Business Models

- Rollover Expert (Non-fiduciary)
- Traditional Advisor (Non-fiduciary)
- 3(21) Co-fiduciary Advisor (Limited Scope)
- 3(38) “Investment Manager” (Independent Fiduciary)
- 3(21) “Named Fiduciary” (Full Scope)

- Outsourcing Model (Available when an advisor and/or its clients are unwilling or unable to take on certain fiduciary roles, duties or functions)

The Rollover Expert (Non-Fiduciary)

- The Advisor is <u>not</u> a fiduciary to the <u>PLAN</u>
- The Advisor <u>may or may not be</u> a fiduciary to its <u>individual rollover client</u>
- Needs to know among other things:
  - Retirement plan distribution rules (specific to each plan)
  - IRS tax rules
  - IRA beneficiary selection
  - Post death IRA issues
  - The integration of IRA distribution planning and estate planning

The Rollover Expert (SWOT)

SWOT

- Strengths
  - Lowest barrier to entry of the six practice profiles
  - Often built on the personal charisma of the advisor
  - Can be easily organized around a repetitive and scalable process with minimal cost
  - Can be practiced within most financial services organizations
- Weaknesses
  - Growth in this model relies on gathering more and more clients (clients are entering
  - distribution phase of life)
  - Advisors who are not "people persons" may struggle in attracting clients and assets
  - Advisors with access to limited products/solutions are at a disadvantage
- Opportunities
  - The first wave of the baby-boomer generation is entering retirement – demographic
  - advantage to rollover experts over the coming two decades
  - The increasing migratory nature of individual employment – every job change in a person's
  - career represents a rollover opportunity
  - Increased market volatility has increased the trend for individuals to seek professional help
- Threats
  - The increase of managed accounts in retirement plans may lead to greater rollover retention
  - by existing providers
  - The possible use of lifetime income products in retirement plans may dramatically curtail the
  - rollover marketplace for advisors
  - The changing fiduciary landscape may prohibit retirement plan advisors from actively

The Traditional Advisor (Non-fiduciary)

- The advisor is <u>not</u> a fiduciary to the <u>PLAN</u>
- Traditionally a generalist (wealth advisory, retirement plans, other products and services)
- Often enters the retirement plan business as a supplement or to feed its individual business

The Traditional Advisor (Non-fiduciary)

SWOT

- Strengths
  - Client relationships are often very strong due to their personal nature
  - Relatively low barrier to enter the business
  - Charismatic advisors can often convince existing clients to give them a shot at the business
- Weaknesses
  - The business model is not scalable
  - The advisor typically does not have special skills or experience which translate into a stable business
  - The advisor must rely on the abilities of its vendor partners
  - The advisor is typically viewed more as a salesperson bringing a product to the client
- Opportunities
  - The increasing size of the rollover business
  - The micro and small plan market offer unsophisticated plan sponsor targets
- Threats
  - The growing trend of financial services firms limiting or curtailing which advisors can work on retirement plans (specialize or become restricted)
  - Changes in the regulatory environment (fiduciary status)
  - The increase of managed accounts in retirement plans may lead to greater rollover retention by existing providers
  - The possible use of lifetime income products in retirement plans may dramatically curtail the rollover marketplace for advisors
  - The changing fiduciary landscape may prohibit retirement plan advisors from actively soliciting rollover business (cross-selling may be prohibited in a fiduciary environment)

3(21) Co-fiduciary Advisor (Limited Scope)

- The advisor is a fiduciary to the PLAN
- The advisor gives "advice" but does not make decisions
- The advisor is often a financial professional generalist (wealth advisory, retirement plans, other products and services)
- The advisor often enters the retirement plan business as a supplement to or to feed its traditional wealth advisory practice
- A growing number of 3(21) specialists are entering the retirement plan business focusing on Plan business

3(21) Co-fiduciary Advisor (Limited Scope)

SWOT

- Strengths
  - A qualified and experienced Co-Fiduciary Advisor is an expert in the retirement plan marketplace
  - The advisor accepts fiduciary status with its clients
  - The barriers to entry are fairly high
  - The business model is scalable
  - Best used with clients that do not wish to transfer fiduciary risk to their advisor
- Weaknesses
  - No transfer of fiduciary responsibilities or liabilities from the plan sponsor to the advisor
  - Not a good business model if the client/its ERISA attorney wishes to transfer risk
  - Client misunderstanding of the protection provided by a 3(21) Co-fiduciary Advisor relationship
  - Potential conflict of interest if an advisor offers additional services to plan participants
- Opportunities
  - The consolidation away from traditional non-fiduciary advisors
  - The increasing awareness of plan sponsors concerning fiduciary matters
  - The trend towards independent advice versus conflicted advice
- Threats
  - The growing trend of financial services firms limiting or curtailing which advisors can work on retirement plans (specialize or become restricted)
  - Changes in the regulatory environment (fiduciary status)
  - The changing fiduciary landscape may prohibit retirement plan advisors from actively soliciting rollover business (cross-selling may be prohibited in a fiduciary environment)

3(38) “Investment Manager” Advisor
(Independent Fiduciary)

- The advisor <u>is</u> a fiduciary to the <u>PLAN</u>
- The advisor should be a specialist/expert in retirement plans
- The advisor should not have another line of business (i.e. rollover business, wealth management which conflicts with its Investment Manager business)
- A growing number of advisory firms are entering the 3(38) investment manager business
- <u>This is a very specialized business model that requires a great deal of expertise</u>

3(38) "Investment Manager" Advisor
(Independent Fiduciary)

SWOT

- **Strengths**
  - An ERISA Investment Manager must be an expert in the retirement plan marketplace
  - This advisor is a decision maker with discretionary investment authority
  - The barriers to entry are extremely high
  - The business model is scalable
  - Best used with clients that wish to transfer fiduciary risk to a third party
  - An excellent business model when working with ERISA attorneys
- **Weaknesses**
  - Not a good business model if the client/its advisors do not understand the value proposition
  - Potential conflict of interest if an advisor offers additional services to plan participants
  - The technical nature of the business model requires a high degree of experience and expertise
- **Opportunities**
  - The consolidation away from traditional non-fiduciary advisors
  - The increasing awareness of plan sponsors concerning fiduciary matters
  - The trend towards independent advice versus conflicted advice
  - The trend towards outsourcing
- **Threats**
  - The limited number of organizations which allow its advisors to accept ERISA Investment Manager status
  - Changes in the regulatory environment which might dilute the meaning of fiduciary status under ERISA (fiduciary status)
  - The changing fiduciary landscape may prohibit retirement plan advisors from actively soliciting rollover business (cross-selling may be prohibited in a fiduciary environment)

3(21) Named Fiduciary (Full Scope)

- The advisor becomes the <u>NAMED</u> fiduciary to the <u>PLAN</u>

- The advisor must be an expert on retirement plans
  - Investment
  - Operational
  - Legal

- The advisor should not have any other lines of business that conflict with its Named Fiduciary practice

- This is a very specialized business model that requires a great deal of expertise

- This is not a very well known or understood business model. It could have a significant influence on the industry in time.

3(21) Named Fiduciary (Full Scope)

SWOT

- Strengths
  - A professional independent 3(21) must be an expert on retirement plans
  - This advisor becomes the decision maker on the retirement plan with discretionary authority
  - The barriers to entry are extremely high
  - The business model is scalable
  - Best used with clients that wish to transfer fiduciary risk to a third party
  - An excellent business model when working with ERISA attorneys
- Weaknesses
  - The concept is not widely understood
  - Not a good business model if the client/its advisors do not understand the value proposition
  - Potential conflicts of interest
  - An advisor will have to be independent in order to operate this business model
  - The technical nature of the business model requires a the greatest level of experience, knowledge and expertise. Most of all, this person must be an expert decision maker.
- Opportunities
  - The increasing awareness of plan sponsors concerning fiduciary matters
  - The growing complexity of operating a retirement plan
  - Plan sponsors have shown an interest in mitigating or transferring fiduciary risk
  - The trend towards outsourcing. Plan sponsors overloaded; looking for solutions.
- Threats
  - Existing business and industry trends that are built on the continuance of the usual Plan Sponsor/Advisor relationship
  - There is a great deal of misinformation in the marketplace surrounding this business model
  - Changes in the regulatory environment which might dilute the meaning of fiduciary status under ERISA (fiduciary status) (however, the opposite could occur, too)

Outsourcing Models

- There are various forms of outsourcing models available to advisors and their clients

- The need for an outsourced solution happens when an advisor and/or its clients are unwilling or unable to take on certain fiduciary roles, duties or functions

- There are three primary fiduciary outsourcing models available today

- From a financial services professional's standpoint, the outsourcing models can be implemented on a practice-wide basis OR on a case-by-case basis

Outsourcing Models (Two examples)

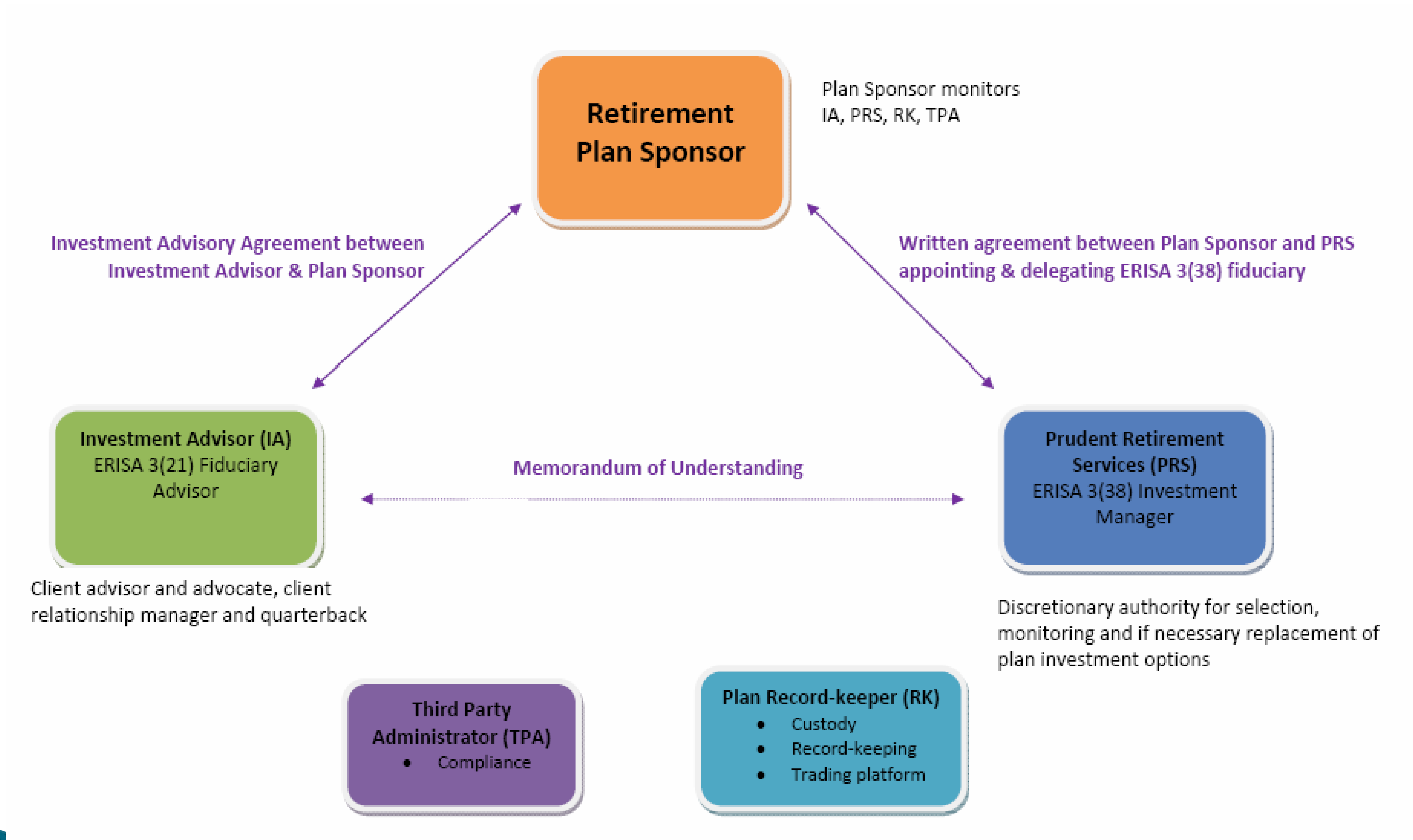
Non-fiduciary Advisor

- Non-fiduciary advisor teams with 3(38) Investment Manager to offer a fiduciary solution to its client
- Client delegates selection, monitoring and replacement functions to 3(38) Investment Manager
- Non-fiduciary advisor assists the plan sponsor with its duty to monitor the Investment Manager
- Non-fiduciary advisor provides education and other non-fiduciary services to plan sponsor and participants
- Rollover services permitted

3(21) Co-fiduciary Advisor

- A 3(21) Co-fiduciary Advisor teams with a 3(38) Investment Manager to offer a fiduciary solution to its client
- Client delegates selection, monitoring and replacement functions to 3(38) Investment Manager
- 3(21) Co-fiduciary Advisor assists the plan sponsor with its duty to monitor the Investment Manager
- 3(21) Co-fiduciary Advisor can provide investment advice to plan sponsor and participants

Fiduciary Outsourcing Model



Step Three – Which Model Works for Me?

- Do an honest SWOT assessment of your own situation
- Thoroughly understand what role you wish to play with your retirement plan clients
- Define the level of success you wish to achieve with retirement plans
- Now look at each business model and see which one best fits your current circumstances
- Select a business model and commit everything you have to it

Step Four – Implement

- Develop a written business plan
- Put into place written policies and procedures to operate your business model
- Develop or acquire any needed expertise to effectively implement your business model
- Periodically evaluate your operation

Q&A

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