Evolution of 401(k) Advisory Fee Arrangements

As plan sponsors have become more aware of their responsibility under ERISA to ensure that only reasonable compensation is paid to their plan providers, and with fee disclosure requirements imposed by regulators, fee arrangements have become more transparent and competitive.[1]

Faced with a decade-long series of lawsuits challenging the "reasonableness" of provider fees, and with greater illumination of expenses afforded by fee disclosure requirements, plan sponsors have aggressively pushed for savings from investment managers and recordkeepers. The upshot of these efforts has been a 40% drop in investment fees for a typical 401k participant and a lowering of administration fees by nearly 45%! [2]

It was only a matter of time before plan sponsors would shift their attention to the advisory component, leading to wholesale disruption in advisory compensation arrangements and rooting out excessive compensation. This has led to the growing popularity of a "fixed fee retainer" model which offers several attractive fiduciary advantages over traditional compensation models as described below.

Commission Model

A decade ago, most 401k advisors were simply investment brokers, non-fiduciaries collecting commissions generated from the investments offered on a particular plan's menu. With the growing concern over potential conflicts of interest associated with such indirect compensation arrangements, and in response to new DOL disclosure requirements enacted in 2012, the retirement marketplace has dramatically shifted away from the Commission Model with indirect fee arrangements declining by 36%.[1]

Percentage of Plan Assets Model

Under a fiduciary arrangement, advisors are compensated on a fee-basis, with the traditional approach employed being a percentage of plan assets model. However, as tremendous scrutiny surrounding "revenue sharing" within the 401k environment has intensified, this asset-based model has come under scrutiny due to the potential exposure for a breach of fiduciary duty on any 'excessive compensation' it may generate for the advisor.

[1] *I Can See Clearly Now: The Impact of Disclosure Requirements on 401k Fees by Badoer, Costello and James, December 2018.*

[2] *ICI:Mutual Fund Fees Continue to Decline For 401k Plans, Bob Steyer, P&I, June 15, 2017*

Flat-Fee Retainer (Subscription Model)

The flat-fee retainer or subscription model has grown in popularity as a more logical and transparent advisory compensation method and potentially better suited to the higher fiduciary requirements demanded by plan sponsors.

It addresses the negative implications under the asset-based approach when an advisor's revenue increased simply by the growth of a plan's assets without incurring any additional workload. With the critical need for plan sponsors to protect against any potential conflicts of interest and to help ensure a reasonableness of advisory fees to services, continued migration to a fixed-fee retainer (subscription model) for advisory compensation may accelerate.

What this means for Plan Sponsors:

- Carefully consider and review your advisory compensation arrangement.
- Commission arrangements may pose conflicts of interest that need to be addressed.
- The percentage of plan asset approach raises the potential risk of excessive revenues being generated and requires ongoing due diligence and benchmarking by the plan sponsor.
- Consider the advantages of a fixed-fee retainer (subscription model) for greater transparency and protection against the potential liability of excessive revenue being generated.

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