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"Pickup" Lines

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Photo by Nick Souza

Does the fiduciary have a duty to pick up the $100 bill and put it back into the plan? Most of us probably would say "yes."

It doesn't require a great deal of effort or expense and, therefore, it is a cost-effective use of the fiduciary's time in behalf of the plan. So, all in all, I think we could agree that the fiduciary has the duty to pick up the money and return it to the plan.

In many ways, revenue-sharing is similar to that $100 bill. The providers and advisers for a plan may be receiving money from the investments, which the 401(k) community commonly refers to as revenue-sharing.

(By the way, the DoL refers to it as "indirect payments"; the securities industry gives it a variety of names, including 12b-1 fees, finder's fees, shareholder servicing fees, and subtransfer agency fees; plaintiffs' attorneys often call it "secret and excessive payments.")

Revenue-sharing is similar to the $100 bill because it is money that can, in some cases, be collected for the participants in a 401(k) plan with little cost or additional effort.

Not in the Open

However, by its very nature, revenue-sharing is not out in the open. Typically, the investments, or the investment managers, pay money to brokers, investment advisers, consultants, recordkeepers, and third-party administrators. The amount of the payments is usually, but not always, based on the amount of the investments.

The practice is pervasive—virtually every 401(k) plan that I work with has some revenue-sharing. That's just another way of saying that the participants are being charged for some or all of the cost of the plan, including the investments and the services to the plan.

Why do ERISA and the DoL care about revenue-sharing? There are two important reasons. The first is that it is impossible to evaluate the reasonableness of payments to plan providers without knowing the full amounts that they are receiving, both directly and indirectly.

The second is that fiduciaries must be aware of, and consider the impact of, conflicts of interest. If your providers or advisers are receiving more compensation, including the indirect payments, when they promote one investment over another, there is a conflict of interest.

Understanding Revenue Sharing

While fiduciaries have a duty to understand revenue-sharing, there is no corresponding duty imposed on nonfiduciary service providers to provide that information.

In effect, the law creates a curious circumstance where the people with the least knowledge about a subject (i.e., plan sponsors) have the legal responsibility to evaluate it, while the people who are most knowledgeable about the same subject (i.e., 401(k) providers) have no legal duty to disclose it.

However, the DoL has revised the Schedule C to Form 5500 for plan years beginning in 2009. The new schedule is designed to report information about indirect payments so

that 401(k) providers will give that information to fiduciaries, at least to plans with 100 or more participants.

The DoL also is working on a new proposed regulation under ERISA section 408(b)(2) that will require greater disclosure for all plans when a plan buys an investment or service. That "point-of-sale" disclosure probably will be effective in 2009.

What should fiduciaries be doing to adjust to these changing circumstances?

Gathering Information

The first step is to gather the information needed to understand the revenue-sharing: Who is paying whom, how much, for what? Tell your advisers, consultants, and providers that you want to know about all direct and indirect payments of money or other things of value that they receive from your plan's investments or any other source related to your plan or its investments.

The second step is to evaluate that information. For larger and more sophisticated plan sponsors, there is one more step: Make sure your recordkeeper has negotiated favorable revenue-sharing arrangements.

Some mutual funds share revenue at different levels, depending on the size and negotiating skill of the recordkeeper. A knowledgeable consultant can help with that analysis.

The moral of the story is that some plan sponsors and fiduciaries are not picking up the $100 bills, not because of bad intentions, but because of a lack of understanding of industry practices. The key is to work with knowledgeable advisers—and to have them prepare full-blown reports on fees, expenses, and revenue-sharing—at least every three to four years.

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