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Disclosing Commissions: The Registered Rep Dilemma



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Financial Advisor ("FA") is a generic term that is often applied to both commissioned and fee-based advisors. Commissioned based FAs collect commissions from retirement plan sales that are tied to individual securities, mutual funds, variable annuities or group annuity products. Historically, FAs that collect commissions are required to have a fiduciary sign a commission disclosure form when the plan assets are placed in a group or individual annuity contract sponsored by an insurance company. However, the sale of mutual funds that provide commissions in the form of front-end loads, finder's fees, and 12b-1 fees to an FA, were typically communicated with the delivery of a prospectus.

Unlike fee-based advisors, FAs have rarely provided retirement plan clients with a service agreement that outlines the services rendered for commissions received. This, of course, has changed effective July 1, 2012, when the new 408(b)(2) fee disclosure rules went into effect. Now, FAs must provide the responsible plan fiduciary ("RPF") with a written disclosure that communicates the fees charged for services rendered. While it sounds easy enough, the Broker-Dealers (B-D) that oversee compliance obligations for their registered representative are challenged to either monitor the FAs delivery of services tied to a custom designed disclosure or implement a standardized disclosure agreement and hope all FAs deliver promised services.

The B-D generated advisor fee disclosures we have seen typically are either standardized or customized.

1. Standardized – This disclosure includes a list of services that applies to every FA under the B-D umbrella.
2. Customize – This disclosure includes a list of services that may be selected under mutually agreeable terms between the FA and the client.

In other words, disclosing fees is the legal OBLIGATION, fee reasonableness is the ISSUE.

Based on our review of B-D service agreements, while many covered service providers ("CSP") will provide a newly designed written contract to communicate fees in accordance with the 408(b)(2) fee disclosure requirements, such disclosures fail to comprehensively protect a CSP compensation arrangement unless reasonableness of fees is addressed, a primary function of benchmarking. In other words, disclosing fees is the required legal obligation, fee reasonableness is the issue. If you do not provide the responsible plan fiduciary with the ability to determine if fees are reasonable, you have met your disclosure obligation, but you have not assisted the RPF to make a determination of fee reasonableness, an obligation emphasized by the Department of Labor ("DOL") in the preamble.

To Contract or Not To Contract?

The 408(b)(2) regulations do not require a CSP to re-write or create a written service agreement. In

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fact, the preamble makes it clear that a contract is not required nor is it a requirement to communicate fees and services in a single document. Yet, many B-D are contemplating the imposition that their registered representative must have their retirement plan client sign a contract that is intended to comply with the 408(b)(2) disclosure obligations.

Fiduciary Risk Assessment ("FRA") provides consulting, expert witness and assessments of advisor expertise. PlanTools, a wholly owned subsidiary, delivers web-based expense analysis, benchmarking, 408(b)(2) reporting, revenue sharing database, standards-based risk management and fiduciary governance solutions. For more information about FRA/PlanTools contact David J Witz, AIF® at 704-564-0482 or dwitz@fraplantools.com

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