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Subject: **Fiduciary Liability, Increased Claims, Inadequate Coverage,
Disgorged Compensation & New Business**

From: CFDD

ECONOMIC CONDITIONS & RETIREMENT PLAN ADVISORS

Our last newsletter noted that few retirement plan advisors were knowledgeable of the events following bankruptcy, plan termination - including partial termination - or the guidelines for orphan plans. Before discussing additional plan design issues, let's review the previously mentioned items advisors should be prepared for during today's challenging conditions:

- Contingent Participant Communications Program Discussing The Protected Status Of The Plan Trust
- Developing A Protocol For Rollover Business When Fiduciary Services Are Offered At The Plan Level
- Monitoring The Deposits Of Salary Deferrals & Loan Payments (In addition to being illegal, late deposits must be reported on the 5500. They may also incur penalties and the cost of restoring earnings)
- Broad Oversight Of Plans Offering Company Stock
- Illegal Loans, Inappropriate Expenses Charged Against The Plan & Changing Vendors Solely To Reduce Costs
- The Legal Duty To Inform Trustees In Writing Of Any Fiduciary Breach
- Knowing When To Walk Away From A Plan

PLAN DESIGN ISSUES & ECONOMIC CONDITIONS

In addition to heightened liability, today's economic conditions could also have an impact on plan design. The challenges and opportunities associated with these issues will be discussed in detail at the CFDD's October 5-7, 2009 Advisor Conference, but advisors should be aware of the retirement plan design issues below:

- The Importance Of Meeting With Trustees To Review & **DOCUMENT** The Plan's Investment Options From A Risk Management & Fiduciary Perspective.
- Reviewing The Viability Of Employer Contributions - Including The Need To Reduce, Suspend Or Eliminate Contributions & Subsequent Employee Communication
- Evaluating & Communicating The Impact Of Contribution Changes On HCE Deferrals, Matching Contributions, Safe Harbor Status & Mandatory Top Heavy Contributions
- Preparation For An Increase In Loans, Hardship Withdrawals & Defaults
- The Impact Of Layoffs On Partial Plan Termination & Vesting

LIMITING LIABILITY

Economic conditions and bankruptcy could be a catalyst for increased liability over issues not previously scrutinized, including unreasonable fees, the lack of an agreement letter, inappropriate decisions, etc.

Bear market claims generally take eighteen months to develop, but claims against advisors are rising. Suitability issues will no doubt account for the majority of new claims, and according to FINRA, **arbitration cases increased 54% in 2008.**

The leading cause of fiduciary claims against first party fiduciaries and advisors is breach of duty. **Breach of fiduciary duty also represents 25% of all claims against advisors and they are expected to increase.**

When viewing liability, it is important to note the difference between claims and potential claims. In other words, 60% of all claims are frivolous, 30% are settled and 10% result in litigation. All claims incur a cost, but **claims that involve court litigation could take up to five years to resolve and may incur more than \$100,000 in legal fees.**

Advisors who do find themselves involved in litigation should be cautious about signing tolling agreements and mindful to note that **there is no attorney/client privilege between advisors and insurance brokers.**

Ironically, ERISA does not require plan sponsors to obtain fiduciary insurance nor does it require RIAs to obtain third-party coverage for fiduciary services. Furthermore, **ERISA does not require RIAs to disclose their lack of E&O fiduciary coverage.**

The overwhelming majority of small plans lack fiduciary insurance (75%) and most advisors lack affirmative fiduciary coverage in their existing policy. Many BD policies don't offer fiduciary coverage or limit it. BD policies may exclude the advisor's entity, activities outside the scope of the BD and are generally subject to aggregate limits for all reps. BD policies often limit prior coverage and they are not portable.

Gary Sutherland (CEO, NAPLIA) will discuss how advisors can limit their liability in detail during his CFDD Advisor Conference presentation on: *Professional Liability Insurance: Recent Trends & Settled Cases*. In the interim, advisors should attempt to limit their liability by following the steps below:

- Obtain An Executed Copy Of The Plan Trust Document
- Evaluate The Client Surety/Fidelity Bond & Fiduciary Insurance Coverage Of Existing As Well As Potential Clients
- Avoid Clients Without Adequate Coverage
- Refrain From Working With or Recommending Advisors Who Lack E&O Fiduciary Coverage
- Review Your Policy, Particularly Exclusions, & Ensure You Have The Correct Fiduciary Coverage For The Specific Services You Provide, Including Acts As A Fiduciary
- If Your BD's E&O Policy Does Not Include Fiduciary Coverage, Purchase A Stand Alone Policy With Affirmative Coverage
- Incorporate Protection Into Your Contracts With Clients
- Avoid Conflicts
- Operate With Full Fee Transparency, Including Referral Fees
- Avoid Problematic/Difficult Clients
- Do Not Promote Capabilities Where Expertise Is Lacking
- Ensure Your Website Accurately Describes Your Services & Skills

In addition to avoiding liability, advisors should **use proof of affirmative coverage for sales and marketing purposes.** Advisors with coverage have an advantage over those who lack coverage. As the industry matures, more sponsors are asking to see the policies and proof of such coverage.

E&O & FIDUCIARY INSURANCE DISCOUNTS

In recognition of our network's professionalism, **NAPLIA is offering CFDD Advisor Conference registrants an EXCLUSIVE discount on their E&O & Fiduciary Insurance policies.** For more information, visit www.investmentadvisorinsurance.com/cfdd, contact Tom Schrandt at (866) 262-7542 or email toms@naplia.com. Again, you must be registered for the conference to obtain this discount.

WHEN TO WALK AWAY FROM A PLAN

Determining when to walk away from a troubled ERISA plan is primarily a legal issue, but best practices and insurance perspectives should be considered. Termination provisions should also be included in the advisor's client agreement. We will discuss this in detail at the conference, but advisors should be on the alert for:

- Clients That Reject Advice
- Problems With Getting Paid
- Client Difficulty With Other Professional Relationships
- Poor Recordkeeping
- Late Deferral Contributions
- History Of Complaints

When an advisor resigns as a plan service provider, it is important to note that **resignation does not alleviate the legal duty to inform the trustees in writing of the concerns and issues surrounding a fiduciary breach.**

UNREASONABLE FEES & DISGORGEMENT

ERISA does not require a plan sponsor to retain the services of an advisor to establish or service a retirement plan, but sponsors are encouraged to retain investment expertise. When outside expertise is engaged, ERISA specifically states that fees paid to service providers must be reasonable for the services rendered to the plan.

As a result of increased disclosure, including non-traditional compensation, **the future for advisors is one of fee justification.** The burden of proof is on the advisor, and while justifying fees is complicated, fee analysis must be relevant to the services rendered.

Business conditions are pressuring corporations and investors, but they are also having a major impact on service providers. With the gross-to-net pricing of retirement plans underwater, **increased pricing could intensify the scrutiny of advisor fees.**

Few non-specialists realize it, but **unreasonable fees are a prohibited transaction.** When fees are deemed unreasonable, the damages could include disgorgement and an excise tax.

Advisors who charge some clients more than others for the same services may be particularly vulnerable. This applies to ERISA plan advisors who are fiduciaries as well as advisors who are simply a party in interest.

To arm advisors with the information necessary to protect reasonable compensation for services rendered, David Witz (Managing Director, Fiduciary Risk Assessment LLC (FRA) & Plan Tools LLC) will give the Advisor Conference presentation: *Prohibited Transactions That Put Advisor Compensation At Risk: Avoid Disgorgement by Navigating the Statutory & Administrative Exemptions.*

PLAN TOOLS DISCOUNT

Leveraging two complimentary software solutions, David Witz's FRA merged with PlanTools, LLC in January of 2009. PlanTools automates the integration of investment performance reporting with Investment Policy Statement design, providing a cost-effective documentation process that saves time and increases profitability. In an EXCLUSIVE offer, **PlanTools is offering a meaningful discount to all CFDD conference registrants.**

For more information, contact David Witz by phone at (704) 564-0482 or email witzdj@earthlink.net. For more information on PlanTools, LLC, visit www.plantools.com.

BENCHMARKING RETIREMENT ADVISOR FEES & PRACTICES

Ann Schleck & Co. has developed a new on-line tool to help advisors compare their DC plan fees and services to a database of fees and services rendered by other advisors. The Fee Benchmarker™ client-ready report helps advisors determine if their fees are reasonable and includes data for both commission & fee-for-service models. For more information, visit: <http://annschleck.com>.

Ann is also developing a diagnostic tool for retirement plan practice benchmarking that will be exclusively launched at the CFDD's '09 conference. The diagnostic tool will include financial performance, sales productivity metrics, staffing, HR practices, pricing and services. **In return for a no-cost diagnostic report, the firm is seeking established retirement practices to participate in their research.**

Ann will discuss both topics during her Advisor Conference presentation on: *Benchmarking Retirement Plan Advisor Practices & Fees*. To participate in the practice management benchmarking research, email Ann@annschleck.com or Sue@annschleck.com.

LEGISLATIVE THREATS

With industry profitability under severe strain or worse, it is ironic that the media and legislators continue to focus on fees. Indeed, no less than three different Democratic 401(k) hearings are scheduled for the weeks ahead.

401(k) plans have been tweaked for almost thirty years and additional non-self serving adjustments could be helpful. It is, however, important to note that like other savings pools, these plans have been a victim of the financial crisis, not the cause.

Given the outlook for social security, stress on the private sector and the growing number of frozen DB plans, it would be constructive for George Miller (D-CA), Nydia Velazquez (D-NY), Herb Kohl (D-WI) and other DC plan critics to recognize that 401(k) plans are all we have left. We would also like to see the DOL and the ICI testify at the upcoming Target Date Fund hearings as to why there are no Stable Value type default options.

Basic security for the masses is a noble goal, but the socialist leaning should be reminded that European policymakers have made promises that cannot be kept. Unfortunately, their general populace is dependent on the delivery of those promises.

On another note, regulators appear to be considering a universal fiduciary standard, equalizing broker & RIA regulation and a single regulatory organization. Elevating the fiduciary standard certainly makes sense, but subjecting RIAs to broker-dealer rules and a self-regulatory organization funded by the industry doesn't make sense. It would also not benefit individual investors.

REVISITING THE BUSINESS MODEL

Regardless of what happens on the legislative front, **the industry must be prepared for more disclosure, fee pressure, litigation, higher standards and a continuation of the challenging economic conditions.** In a strong departure from the past, the coordinated efforts of key nations, including unconventional policies which circumvent the banking system, could alleviate the housing crisis and reduce the impact they have had on all sectors of the global economy.

The balance sheet burden imposed by government-sponsored private banking systems will be enormous, but sovereign nations are the only entities that can stabilize the crisis. The financial markets are not happy with the lack of details, but given the consequences of failure, a solution will probably be found.

A solution will, however, require political leadership and no new shocks, like a major terrorist event. Unfortunately, **the healing process could take years.** As a result, **we must be prepared for an extended recovery period and less than rewarding equity markets.** The Treasury market could also come under pressure.

Business models are a work in progress and mature markets demand the best from all of us. In addition to focusing on efficiency, client retention, defining & communicating value, honing no cost marketing skills and limiting liability, **we would all benefit from revisiting & refining our business models.** Analysis of the business model should include not only pricing, but alliance partners, product lines, growth opportunities and an expanded gatekeeper role.

Advisors looking to improve investment returns should also consider alternative approaches to traditional asset allocation, automatic rebalancing, diversification, broad indexing and risk management. Like it or not, we are entering a brave new world. Investing in undervalued assets has always been smart, but it won't generate positive results unless the assets have the potential to recover from depressed levels.

The simultaneous expansion of wealth planning teams and the fee-for-service RIA model have helped fuel ETF growth. Many advisors use ETFs as index tracking tools outside of retirement plans and growth is expected to continue. As a result, we are pleased to note that Scott Burns (Director of ETF Analysis, Morningstar, Inc) will be directing the Advisor Conference session on *ETFs & Individual Portfolio Construction*.

DEVELOPING NEW BUSINESS OPPORTUNITIES

The CFDD's next newsletter will be devoted to the development of new business opportunities. Advisors would, however, be wise to revisit our previous newsletter comments about DB plans.

As previously noted, cash balance and traditional DB plans will remain attractive to small, profitable, closely held corporations and other select entities. DB & 403(b) plan combinations are also generating new business.

On the other hand, many DB plans are suffering from the economic downturn and the resulting impact on 2009 funding obligations. This will likely trigger more plan sponsors to freeze their plans, adding to the significant number of DB plans that have already been frozen.

According to a late 2008 GAO sample survey, **half of all plan sponsors in a single-employer survey had at least one frozen DB plan. Hard freezes (all future benefit accruals ceased) accounted for half of the total plans frozen. The implications of a freeze vary and while they are too costly to terminate today, hard freezes have a high future probability of termination.**

Terminating a DB plan is a complicated and time consuming process that includes strict criteria for participant notices, IRS/PBGC filings and the ultimate distribution of plan benefits. The distribution may include procuring an annuity or, if offered, processing lump sum distributions.

Advisors who procure terminal annuity bids now will position their clients to receive periodic updates that measure the actual cost of plan liquidation rather than relying on actuarial estimates. By being proactive now, advisors are also positioning their clients to take advantage of a rise in interest rates which would reduce the cost of terminal annuities.

The *Consulting Services Proposal* should summarize the steps for procuring terminal annuity bids, including RFP preparation, annuity sourcing, proposal analysis, written reports, client meetings and corresponding fee analysis. It is also customary to request an "initial" payment to start the DB engagement/consulting agreement. Additionally, **DB plan engagements are a proven entry point for DC plan consulting.**

Brian Hubbell (Principal, Hubbell Consulting, LLC) will discuss this in detail during his Advisor Conference presentation on: *The Future Of DB Plans: Why & How Advisors Should Engage Clients Now*. **Rather than wait for the conference, Brian has agreed to provide guidance for advisors who are registered.** Brian can be reached by email at: bhubbell@hubbell-llc.com or by phone at (704) 887-4930. If you are not yet registered, see the section below or go directly to: <http://www.thecfdd.com/CFDDconference2009>.

CFDD 2009 ADVISOR CONFERENCE REGISTRATION

Online conference registration and hotel reservations can be made from the conference homepage located at: <http://www.thecfdd.com/CFDDconference2009>. With more accomplished retirement plan advisors in attendance than any other event, the content rich conference sells out early. To guarantee attendance and benefit from unbiased guidance, direction and exclusive new tools & resources that will be unveiled at the conference, register at a discount NOW!

Exhibition space is limited and more than half of the available booths have already been selected. If you plan to exhibit, it is strongly suggested that you choose your booth location early. The agenda is developing quickly and, if you would like to participate or suggest a topic, now is the time to get involved.

Consistent with our Old/Wild West theme, **the 2009 Advisor Conference will feature a Grand Prize Luxury Dude Ranch Vacation, a dream getaway for two at one of the nation's top resorts.** ALL registrants are eligible for the Grand Prize Vacation, the Western Attire Awards and the Raffle Prizes.

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