

Retirement plan brokers outsource fiduciary duties

Morningstar, Wilshire and Mesirow lead effort to manage small plans

By **Darla Mercado**

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As the Labor Department and lobbyists wrangle over who can provide advice to retirement plan participants, the marketplace has come up with an increasingly popular solution that satisfies current and potential requirements.

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The solution involves outsourcing fiduciary functions, and several investment advisory firms — chief among them Morningstar Investment Management, Wilshire Associates Inc. and the advisory arm of Mesirow Financial Holdings Inc. — now are providing investment menu design, fund selection, market commentary and other services to small-plan sponsors and the broker-dealers and insurers who sell such plans.

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In 2011, Mesirow set up fiduciary outsourcing relationships with seven providers, including Security Benefit Corp., Mutual of Omaha Insurance Co. and Massachusetts Mutual Life Insurance Co.

Morningstar began a similar relationship with Eagle Strategies LLC, New York Life Insurance Co.'s registered investment advisory unit, and Wilshire teamed up with Axa Equitable Life Insurance Co.

"There are a lot of people interested in these services," said Kevin Chisholm, a senior analyst at Cerulli Associates Inc., which estimates that small 401(k) plans (under \$10 million in assets) amount to a nearly \$750 billion market. "Since the 'definition of fiduciary' rule will be looked at in 2012, you need someone who can take that fiduciary responsibility and serve as a partner with the plan sponsor."

The firms involved in the business generally provide fiduciary services in one of two ways.

Acting under Section 3(21) of the Employee Retirement Income Security Act of 1974, an asset manager becomes a co-fiduciary and shares fiduciary responsibility with the plan sponsor or the qualified representative who sold the plan. Under this arrangement, the manager suggests a plan's fund offerings, which the adviser can help select.

Alternatively, under what's known as a Section 3(38) investment management fiduciary service, the manager assumes discretionary authority for the plan and selecting its investment lineup. Under this arrangement, reps who sold the plan have no investment input but can provide educational services, leaving the door open to capturing rollover business when participants leave the plan.

For the more comprehensive 3(38) services, large managers such as Mesirow collect about

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5 basis points from each plan; they receive 2 to 3 basis points for 3(21) services.

Reps in a 3(21) arrangement, where certain functions are shared with the outsourced manager, must be able to work through their broker-dealer's RIA. They don't receive compensation from the mutual funds they select, but may charge an advisory fee.

Brokers and agents in 3(38) arrangements can receive compensation from the funds the manager has screened and approved. Managers, of course, work within the confines of the investments offered on the platforms of the providers with which they have business arrangements.

"As a broker-dealer, if you want to keep your reps in the green zone so that they can cross-sell IRA rollovers, you'll want zero opportunity for the rep to have any input into the plan," said Jason C. Roberts, chief executive at the Pension Resource Institute.

Among broker-dealer clients, 3(21) arrangements are growing faster than 3(38) deals because dually registered advisers like the degree of control they and their plan sponsors have in determining a plan's investment choices, noted Michael Annin, senior managing director of investment strategies at Mesirow.

Meanwhile, 3(38) programs are "generally well suited to advisers at broker-dealers that don't allow any kind of fiduciary status and don't feel comfortable taking on that kind of liability," said Paul Mahan, director of retirement consulting services at **Commonwealth Financial Network**, which allows a select group of its plan advisers to act as fiduciaries, rather than outsourcing those duties.

Retirement plan providers and record keepers who sell plans to small businesses directly — a market estimated at \$175 billion in plan assets — also are asking about 3(38) services, said Terence Geenty, senior investment consultant at Morningstar Investment Management.

"Providers have made it clear that they're not a fiduciary, and we've seen more of them realize that they need something, which is why they're turning to us," he said.

ERISA experts also foresee that record keepers will want to offer an array of managers who can handle fiduciary duty.

"Right now, managers might have an exclusive contract with some providers, but I think we'll end up seeing multiple managers on a platform," said Marcia S. Wagner, an attorney at The Wagner Law Group.

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