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Skill in Fiduciary Discretion Discussions Brings Lots of Low-Hanging Fruit

Independent advisory shop founder Joe Gordon talks about winning new plan business from brokers and bank advisers who are "seriously fumbling the discussion with clients about fees and fiduciary change."

By John Manganaro

Gordon Asset Management is an independent investment advisory firm working with wealth management clients and employer-sponsored retirement plans—either with managerial discretion under Employee Retirement Income Security Act (ERISA) Section 3(38) or without discretion under ERISA 3(21).

One thing that makes the firm unique, says founder and managing partner Joe Gordon, is that it charges the same price to plan sponsor clients for choosing either 3(21) or 3(38) service. Explaining how this works, Gordon first points out that, if an adviser is a non-discretionary fiduciary under 3(21) rules, it is not actually necessary that he pays to have an ERISA bond.

"But once you take on discretion under the requirements of Section 3(38), even if you never actually touch the money, you are required to have a fiduciary bond as an adviser in that situation," Gordon explains. "That represents about $500 of cost to be a 3(38) manager on every plan. The reason we don't charge any more for our 3(38) service is that we save a lot more than $500 in time and staff resources when we have full discretion over the investment menu. In short, this approach is so much more streamlined and repeatable."

For this reason, Gordon calls it "puzzling" to see competitors at conferences "beating their chest because of how great their 3(38) service is," and to see that they charge potentially a lot more for 3(38) service compared to 3(21). Not really a surprise, Gordon says it has been an effective sales strategy to stand up in front of prospective clients and offer both services at a single price point.

Taking a step back and describing the competitive landscape in which the firm operates, Gordon says there is still actually quite a lot of low-hanging fruit for advisers who want to grow. This is in part a result of the fiduciary confusion of recent years, but also because of the longer-term impact of fee disclosure regulations and a shift of market sentiment in general.

"Last year, in anticipation of the fiduciary rule becoming effective, many plan sponsors learned for the first time their 'adviser' was not acting as a plan fiduciary, even though many advisers had implied they were acting in a best-interest capacity," Gordon argues. "Most notably, we won five plans from banks recently because bank advisers have fumbled the transition in explaining why R-6 share classes are needed now. These plan sponsors' decisions had relatively little to do with the quality of recordkeeping or other services—just plan sponsors feeling they had been duped."

Gordon says there are a lot of individual advisers out there working for banks and other providers who are continuing to fumble the language around the transition to more level-fee, fiduciary-based business.

"I have some sympathy here, because it's not an easy thing to explain to clients—what the changes over the years in the law have meant and why new fees are being broken out and made explicit, and why revenue sharing is getting such a bad association among some circles," Gordon says. "Making matters more complicated, I would say that three out of four plan sponsors don't fully get what is going on, in terms of the shift in fiduciary responsibility and expectations."

On the flip side, he also sees affiliated advisers having continued success when they can be clear and cogent about what changes in fiduciary status and fee structures ultimately mean. For example, he recently ran into a situation where his firm unsuccessfully responded to an inquiry from a plan being served by a bank adviser.

"We didn't win that plan in the end, and when we asked why, we learned the plan first had been under 3(21) service, but they had just recently moved to 3(38) for hardly nothing, something like an 8 basis point increase in the fee," Gordon explains. "When you added it all up, the fee was 25 basis points all in for the services the bank and the adviser were providing. In that case the plan sponsor felt like they were getting a good deal and they were confident they understood exactly what they were paying for and why."

In that respect, probably the most important part of managing fiduciary change is figuring out the messaging the firm will put forward to clients—and, of course, maintaining quality service, whatever specific advisory model is being deployed.

"Still, I would say to your adviser readers that this is low-hanging fruit, because traditionally the banks serving this area have not acted as fiduciaries, especially when we focus on the smaller plan market, say under $10 million," Gordon adds. "From my perspective, it has only been since say July 2012, with the covered service provider disclosure rules coming into effect, that anybody apart from the registered investment adviser has truly acted as a plan fiduciary. That's just the reality in the marketplace in my opinion—the bank channel is ripe for picking off, and that's where we are applying our marketing time."

To sell successfully in such an environment, Gordon says it "takes somebody who really grasps the full notion of being a fiduciary, who understands why certain conflicts may be permitted under SEC rules that are not permitted under the DOL rules."

"If I was a bank adviser and I had a client asking why there were previously in an R3 share and paying 50 basis points to the bank's broker/dealer, I would just go in and say, 'Hey, we are now lowering that fee by 50 basis points by going from R3 to R6. And now were are required by law to become a fiduciary, and our fee for taking on that role is 50 basis points, so on net, there is no change for you,'" Gordon muses.

Another peripheral issue here for advisers to consider, Gordon says, has less to do with the Department of Labor and ERISA and more to do with the Securities and Exchange Commission (SEC). Certainly the SEC's new conflict of interest rulemaking effort is important, but there are other pressing matters to consider.

"I was just speaking with a number of advisers who have been recently through SEC audits," he explains. "They said the SEC specifically is now telling them to carve out retirement assets when talking about the size of their firm. SEC is warning pretty strongly that you cannot talk about the retirement assets as 'assets under management' unless you are in fact a discretionary manager of those assets—i.e., a 3(38) manager. Otherwise, in terms of marketing and talking about your firm with prospective clients, you have to carve out the retirement assets and say they are 'assets under advisement.'"

This may seem trivial, but the distinction between the two is an important one from the perspective of the SEC. It should also be an important distinction for advisers thinking about scale and future growth.

"One the wealth side and when dealing with plan sponsors, if you don't have discretion, you spend more time dealing with the emotional aspects of advising and really pushing people away from making hasty or inappropriate changes," Gordon concludes. "So that is another reason we really like taking on discretion in general, because it enables us to do our job without all the interruption and hassle that can come with 3(21)."

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