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As Industry Takes Sides in SEC 12b-1 Debate, Will 401k Plan Sponsors Benefit?

By Chris Carosa | August 12, 2010

It's been three weeks now since the SEC issued its press release on 12b-1 fees. The financial services industry appears to be lining up in a predictable fashion as each side prepares for the coming fight. The bigger question for the 401k plan sponsor is: What can I learn from the upcoming debate within the industry?

FiduciaryNews ask industry insiders what they thought about the new proposal. Some of the things they said may surprise you.

Joe Gordon, Managing Member at Gordon Asset Management, LLC, feels "12(b)1 fees are a notion that has outlived its usefulness. Fund companies do not need to charge these to distribute shares and collect assets. But, if the fees were fully disclosed, transparent, and flashing like a red light, then buyers would not be so easily duped."

Non-adviser providers like recordkeepers have also expressed concern. Lowell Smith, President of InspiraFS, Inc., say, "This will fundamentally change the way recordkeepers, including IRA recordkeepers like Inspira, price retirement plans and partner with distribution channels. In the retirement plan marketplace, this type of change without subsequent changes to systems, contracts and fee schedules will cost firms a lot of money and potentially be an extreme hardship financially during a period of already hard financial times. My hope is that enough time is given to implement such changes."

Still, investment advisers who don't use 12b-1 fees, express an often stark view of their use, but remains wary of government intervention. Tim Wood, Corporate Retirement Plan Fiduciary at Deschutes Investment Advisors, says "I think 12b-1, fees when introduced in an ERISA environment, are not consistent with best practice because it can lead to disparate treatment: those participants that invest in the funds that levy 12b-1 fees are disproportionately paying the freight of the plan. I would like to see 12b-1 fees done away with entirely. However, I would prefer the industry do it on its own rather than through legislative fiat."

Despite evidence from the ICI showing the use of 12b-1 fees on the decline, many service providers, however, continue to use them. Elmer Rich III, Principal at Rich and Co., wonders "how will plan and participant services be paid for?" He expresses concern that "anything the industry tries to do is immediately 'tagged' as self-serving and 'dishonest.'" He would prefer we continue to research evidence of other models, specifically how countries like India, Australia and Britain have experienced these matters. Rich suggests these models "were not successful."

Jeanine Broderick, CFIRS, FLMI, AIRC, ACS, Director of Compliance and Risk at Capitol Wealth, feels the attention

paid to individual fees can mislead. She likens it to buying a house or a car "When I buy a car, I don't know how much the salesperson is making or how much the dealer is making nor do I know how much the person who installed the steering wheel (a very important aspect of my vehicle) made for performing that task." She sees the role of regulators as more important, similar to the role of building inspectors when buying a house. She explains, "When I buy a house I don't know how much the electrician made. Goodness, what if he was underpaid and took a shortcut? My family could be at risk of a fire. Shouldn't I know if he was compensated adequately for doing a good job? How do I judge whether the electrician did what he should have done? What about the plumber? If the plumber was not paid enough he could try to make up for it by using shoddy materials which could result in costly repairs. Oh, we have building inspectors. Yes, I see. Don't we also have DOL, IRS, SEC, FINRA and state regulators watching investments? Are county building inspectors so much better at their jobs than the DOL, IRS, SEC, FINRA, and state regulatory employees?"

Broderick sees investments and retirement accounts as being like homes and cars. She acknowledges "a way to compare how much it costs me to have my investments in my employer plan vs. an IRA would be helpful to me. If I am not receiving a match and not saving more than I am allowed in an IRA this would allow me to make a better decision. I do not think I need to know how much person A, person B, Firm A and Firm B ad infinitum make. I think it clutters an already complicated area for many participants."

Furthermore, she see the potential new 12b-1 rule as increasing the burden on the plan sponsors, who "need a way to make good decisions about which plan provider they decide to utilize. Cost and expenses are one of those factors. I am not confident that requirements that increase costs because of mandated disclosures are the right path. It seems that a simple disclosure of total flat and variable costs would be adequate for the comparison."

Wood counters this argument by saying, "I find that in the current 401k environment, information is so scarce, it is difficult for the average person to be able to correctly analyze their own situation to assess if the value of what they are receiving justifies the cost."

It remains unclear if the SEC's proposal will address any of these concerns, as the SEC's concern deals with the entire mutual fund industry, not just the retirement plan environment. Indeed, the issues within the taxable/retail side of 12b-1 may outweigh those of the retirement industry. What has become clear, however, is the predictable sides industry players are taking. At the very least, this may shed some light on the inner workings of plan service providers, which may, in the end, provide the greatest benefit to 401k plan sponsors.

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