

THE
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ERISA and the Internal Revenue Code: Interesting Angles on the DOL's Fiduciary Rule #11

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This is eleventh article about interesting observations "hidden" in the fiduciary regulation and the exemptions.

ERISA and the Internal Revenue Code limit compensation for services to plans and IRAs to "reasonable" amounts. Prohibited Transaction Exemption (PTE) 84-24 and the Best Interest Contact Exemption (BICE) also limit compensation to reasonable amounts.

While the concept of reasonable compensation is old-hat for advisers and service providers to ERISA qualified retirement plans, it has not, by and large, been used in the IRA world. As a result, some people are asking . . . what is reasonable compensation? The DOL explained the concept in a preamble:

"The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA and the Code. ERISA section 408(b)(2) and Code section 4975(d)(2) require that services arrangements involving plans and IRAs result in no more than reasonable compensation to the service provider. Accordingly, Advisers and Financial Institutions - as service providers - have long been subject to this requirement, regardless of their fiduciary status. At bottom, the standard simple requires that compensation not be excessive, as measured by the market value of the particular services, rights, and benefits the Adviser and Financial Institution are delivering to the Retirement Investor.

The reasonableness of the fees depends on the particular facts and circumstances at the time of the recommendation. Several factors inform whether compensation is reasonable including, inter alia, the market pricing of service(s) provided and the underlying asset(s), the scope of monitoring, and the complexity of the product. No single factor is dispositive in determining whether compensation is reasonable; the essential question is whether the charges are reasonable in relation to what the investor receives."

In other words, "reasonableness" is defined by free market practices . . . in a market where the costs and compensation are transparent and, therefore, where the market is truly competitive. As a result, broker-dealers, RIAs, insurance companies and banks will need to use market data to evaluate the compensation they receive for the distribution of their products and services to plans and IRAs.

Benchmarking is on its way to IRAs. Expect compensation to drop - for the more "expensive" advisers.

The views expressed in this article are the views of Fred Reish, and do not necessarily reflect the views of Drinker Biddle & Reath.

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