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DoL Fiduciary Rule Requires Reasonable Compensation
Supreme Court Says What Reasonable Is

(September 20, 2016) The Best Interest Contract Exemption forces advisers with IRAs or retirement plans to divest all unreasonable compensation. But what exactly is reasonable? A new paper from DALBAR, "*Assessing Compensation Reasonableness*", examines this question and offers some surprising answers directly from the orders of the US Supreme Court.

In its 2010 decision (Jones v. Harris), the Court affirmed the 25 year old standard for reasonableness and discredited benchmarks that included anything that was not an "arm's length" arrangement. The affirmed standard (derived from Gartenberg v. Merrill Lynch) requires that the determination of what is excessive be based principally on the nature and quality of services, adviser performance, cost of providing services plus a profit and must recognize economies of scale that are passed on to investors.

Using this framework, DALBAR gives examples of how very normal situations can appear unreasonable but using the guidance from the Supreme Court, they prove to be quite reasonable. In the first example, an adviser receives 95 basis points on a $700,000 account or $6,550, which is far in excess of an average. It turns out that when all factors are considered a reasonable compensation would be $11,340. This difference illustrates the potential effect if advisers ignore the Supreme Court orders.

"*Assessing Compensation Reasonableness*" describes requirements for creating an "arm's length benchmark" and the complexities of excluding special situations that artificially produce considerably lower compensation. The Supreme Court's warning on use of adviser benchmarks is also covered.

A copy of the full report is available at: http://www.dalbar.com/assessingcompensationreasonableness.pdf.

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