

THE ADVISOR

JULY 2006

VOL. 2, NO. 3



CLEARPOINT
 Financial

720 Olive Way

Suite 1700

Seattle, WA 98101

(206) 962-2000

Boston:

(617) 965-1795

Minneapolis:

(612) 373-7040

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DO WE STILL NEED ADVICE?

Financial advisors have played a key role in the evolution of the investment advice model, and its growing acceptance among plan sponsors (who may care less about whether something is technically "advice" or just a level of guidance that is sufficient to help participants). We recently asked a group of financial advisors who have obtained the PLANSPONSOR Retirement Professional designation (PRP) what they thought about the need for advice.

"There will always be room for advice when plan sponsors and plan participants believe that lifestyle funds are the 'be-all and end-all....Their due diligence ends with the question of 'When do I expect to retire?'"

Mike Miller, executive director of investments at Oppenheimer & Company in San Francisco, notes: "In today's world of

lifestyle funds, I'm getting more and more questions about the type of value I might bring to the plan when it comes to investment advice....All too often I come across lifestyle funds that consist of a couple of great funds, a couple of so-so funds, and a couple of poor funds. So goes the world of investing in a single fund family."

"The participant will need to understand how target-date retirement funds or lifecycle funds work and why they benefit from them," says Will Marquis, vice president at The Baker Companies, a member firm of National Retirement Partners, in Wellesley, Massachusetts. "Advice may change from 'here is an allocation you need' to 'here is the allocation you need and here is the fund that does it for you'."

Despite the storied participant inertia, they do pay attention to their retirement plan statements—and, as they did before the recent

market downturn, seem likely to do so again as the market continues to strengthen.

"Here is the real rub with advice—who is giving it?" cautions Dorann Cafaro, who heads The Cafaro Group, located in Little Silver, New Jersey, a member firm of National Retirement Partners. "So, you add a managed account option and the advice is given by the brokerage arm or the advisory arm of your vendor, or will it be given by Ibbotson/Morningstar services or by the local RIA who also monitors your fund lineup? Is the advice driven by the demographics or is it driven by the economic model of an advisor? No matter what option you choose you are taking someone's advice." Cafaro adds, "A better question is do we need to pay additional fees for advice?"

JUST OUT OF REISH: THE STARTING POINT

A Shift in Focus for the 401(k)

Government data and industry surveys alike confirm that defined contribution plans have replaced defined benefit plans as the predominant choice for providing retirement income.

While those conclusions are not alarming, the results are problematic—at least for today. That is because 401(k) plans never were intended to be the primary vehicles for retirement benefits. Instead, they were intended to be "supplemental

plans," supplementing the annuity income from the primary plans: defined benefit plans. As a result, we now expect 401(k) plans to be something that they never were designed to be. However, I doubt that the retirement clock will be turned back to the old days. So, we face the issue of converting 401(k) "savings" plans into 401(k) "retirement benefit" plans. In my opinion, that conversion will happen, and will happen fairly quickly. It is also my opinion that changes will occur primarily in terms of the perceptions, products, and services by employers, plan

providers, and advisors, while the federal government will play only a supporting role (though it can assist in significant ways, such as providing the anticipated guidance on a safe harbor for automatic enrollment plan designs).

Incidentally, there may not be a need for significant changes in the law to accommodate that shift in focus, since the fiduciary rules already are drafted broadly enough. For example, ERISA requires that fiduciaries act for the exclusive purpose of



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providing retirement benefits. A reasonable interpretation of the language would mean that fiduciaries must focus on the actual benefits being produced by 401(k) plans, as opposed to the current culture of looking at a plan's features and services. Also, the prudent man rule requires that fiduciaries act as a knowledgeable investor (or "prudent expert") would in accomplishing the "aims" of the plan. If the aim of a 401(k) plan is to provide adequate retirement income, then prudent fiduciaries should focus first and foremost on whether or not the plan actually is accomplishing that goal. If it is not, then the prudent man rule would require that fiduciaries determine why the plan is not working and take prudent steps to improve its performance.

If the purpose of these plans is to provide adequate retirement benefits, then the first piece of information provided to participants should be the amount that they must defer in order to accumulate those benefits. Utilizing reasonable assumptions, we can estimate that amount, taking into account their Social Security benefits.

Then, approximately every year, the employee should be given an update. Is the participant on schedule, utilizing the appropriate assumptions? If the employee is

behind schedule, the communication could suggest an increase in deferrals to an appropriate level. In fact, the employee could elect to have his deferrals automatically increased based on the calculations done by the provider or, potentially, reduced, if the employee is ahead of schedule. The communication also could note that the participant can calculate different scenarios—perhaps investing more aggressively or more conservatively, rather than changing the deferral level.

Isn't this concept based on defining a benefit, then funding it? The defined benefit would be the monthly distributions that the participant would need in retirement, discounted to a lump sum amount (that is, the account balance) at the anticipated date of retirement. In other words, this approach applies defined benefit concepts to 401(k) plans.

Continuing with this analogy, the annual "funding" (i.e., deferrals and anticipated employer matching and profit-sharing contributions) is the functional equivalent of the required annual contributions to a defined benefit plan, except that they are required as a practical, rather than as a legal, matter. The calculation of those

annual contributions is, in a manner of speaking, a concept similar to the minimum funding standard account calculations for a defined benefit plan.

Assuming my view of the future is correct, employers, providers, and advisors have to develop the services to support that concept. They must provide participants with information, both initially and along the way, about appropriate deferral rates, taking into account employer contributions and Social Security benefits. Once the services are in place, new products need to be created. For example, my impression is that age-based lifecycle funds are, at this time, more focused on the risk-and-reward trade-off at various ages than they are on accumulating adequate retirement benefits. Also, products need to be designed that are appropriate for the distribution phase, regardless of whether the distribution will be made from the 401(k) plan or from an IRA.

-Fred Reish

ADVISORS: ONE SIZE DOESN'T FIT ALL

July 3, 2006 (PLANSPONSOR.com) – Chicago - The need for financial planning and investment advice may be even more critical for smaller plans, where a plan sponsor must often wear many hats – including many that have little to do with making decisions about participants' retirement savings.

Panelists at *PLANSPONSOR's* Plan Designs 2006 conference told attendees that in those situations a plan advisor can take on some of the work - but not the responsibility – from the shoulders of the plan sponsor.

Even if a plan only has a small number of participants and sponsors think that they can go directly to the provider for services needed, "there is an inherent conflict-of-interest if you let the providers do it all," said Gary Josephs, PRP, Managing Partner at Castner Josephs Retirement Group, maintained at the Plan Designs 2006 conference in Chicago last week in a panel

entitled "Does Your Plan Need an Advisor?".

However, all plan advisors are not a fit for all plans, warned Stig Nybo, Senior Vice President, Transamerica Retirement Services. "Not every advisor qualifies. Some don't have enough 401(k) experience, and certain plans require expertise that may or may not be present." Nybo said.

Nybo said plan sponsors must make sure that the advisor is a credible resource on the overall retirement plan industry, investments, and on participant communications. Nybo also said that plan sponsors need to make sure that they have etched out the plan's design so that the advisor can provide the features the plan requires without tacking on features that a small plan has no use for.

The full fee disclosure trend that has

slammed large companies has not yet been felt by small companies with the same potency, making it even more important for small companies to demand a full record of fees and services, warned Josephs. Even if sponsors think they are getting fair rate, they may not really know what they are paying. Nybo said the best way to remedy that ambiguity is by demanding extensive reporting of fees and services.

Advisors might also take on the role of educating participants about their plans; however, Nybo suggests the time spent with participants be significant enough to make an impact. "You don't get people educated about their retirement in one hour. You really have to carve time out to educate them, even if that means sometimes making the meetings mandatory," Nybo said.



SEAMLESS TRANSITION: TRANSITION MANAGEMENT

Transition management—a business predicated on the successful movement of assets from one place to another—today finds itself squarely in the crosshairs of change.

More transitions, and more types of transitions, are undertaken now than has ever been the case. Indeed, as plan sponsors rethink their asset allocations in more radical fashion than in the past, the complexity and importance of transitions seem likely to increase. Moreover, the continued emphasis on transition costs (both real and opportunities forgone) and non-investment alpha in a returns-challenged environment will only underline the importance of cost-effective transitions going forward. All this at a time when there is no little amount of turmoil among transition providers themselves: Teams are hopping from one player to another, while other players seem to ratchet their commitment up or down at the drop of a hat. Finally, the focus of transition management is evolving, and today is as much a risk management tool as a trading strategy.

In short, plan sponsors are facing an industry in flux. That said, overall, plans appear to like what they are receiving.

Average scores in our 2006 survey remain high, responses gave few indications of any serious problem areas, and that client

satisfaction has helped fuel continued business growth. Among the managers profiled in this survey, the number of transitions was higher in 2006 than in 2005, as were the values traded. Success has attracted imitation—while a handful of players still dominate the space (with State Street Global Markets clearly at the fore), the number of providers establishing or ramping up their emphasis on transition management continues to grow (Bear Stearns, for example, is a new entrant). Likewise, the consultant community, historically slow to come to terms with the complexities of understanding transitions, has grasped this nettle, and now is aggressively engaged in helping clients navigate the choices they face when it comes to transitions.

Despite the heightened attention, these choices remain complex. Very different business models exist in the transition space, both adding flexibility and compounding the complexity of choice. At least a few investment banks—specifically Credit Suisse and Merrill Lynch—now are showing new flexibility as to their willingness to act as fiduciaries, and their approaches are proving efficacious. (Some providers dismiss the "fiduciary" word as pure marketing, but plan sponsors seem receptive.) Of course, perhaps the most complicating factor is the reality that no single transition is alike and, thus, a cookie-cutter approach to

transitions has proved elusive. In many ways, transition management is emerging as the short-term equivalent of asset management. Rather like securities lending before it, transition management is evolving from a stand-alone strategy to a more complex part of a larger whole. Transitions now demand real intellectual capital—and plan sponsors, particularly at the more sophisticated end, are recognizing this.

Historically, intellectual capital in this space has been the domain of a handful of investment banks—historically, Goldman Sachs and Morgan Stanley and, more recently, State Street Global Markets and the Russell Investment Group. In this period of change, Credit Suisse, Merrill Lynch, and Lehman Brothers have emerged as the new leaders, while Goldman Sachs and Morgan Stanley, whether by omission or commission, in this year's survey results, appear to have lost their way. State Street remains the institution, year in and year out, that shows unchanging progress. Russell likewise is perceived as committed and innovative, and is held in extremely high regard by its institutional clients. They are joined in this year's survey by two other players, each winning five Best in Classes—Mellon Transition Management Services and Bank of New York.

THE CASE FOR ADVICE

In fact, offering advice actually may reduce a sponsor's liability under such circumstances. "If the protection of 404(c) is not available, the engagement of an advice provider should limit the plan sponsor's liability for those participants that implement the advice, since participants should have a superior result using the advice than if they had managed their own investments," writes Scarlett Ungurean, a principal with Mercer Investment Consulting in Boston, in a white paper published last year.

The Department of Labor has taken a similar viewpoint; for several years now, officials there have been arguing that offering advice could reduce the potential for employee dissatisfaction and litigation, as long as the sponsor acts prudently in selecting the vendor. In the SunAmerica advisory opinion

it issued in 2001, the DoL specifically permitted investment managers to offer investment advice developed by an independent third party to participants in 401(k) plans.

Many plan sponsors have taken these developments to heart. "There's always a risk in anything we do, but we think there's a greater risk in doing nothing," says Alcoa Manager of Savings Plan Administration Bob Kleckner. "I think it's more prudent to offer advice and give participants a range of tools to help them make informed decisions. Education alone doesn't do it."

If you are looking to hop aboard the advice bandwagon, there are some caveats to keep in mind. First, follow the

established model and hire an independent third party to offer the advice, rather than doing it yourself. Do not let your treasurer or vice president of human resources counsel other employees on how to invest. "The idea of the company or its plan fiduciaries giving direct investment advice to employees as to how to invest their money, we believe, would increase liability dramatically," warns Michael Price, vice president of management liability for Hartford Financial Products, a subsidiary of Hartford Financial Services Group that provides fiduciary liability insurance for plan sponsors. "However, making available a third-party investment advisor as part of the services or benefits you offer to your employees would be considered a way to mitigate liability. From an employer's perspective, you're

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saying, 'We've given you everything we have at our disposal to help you become most informed.'"

Price will not go so far as to say that offering advice actually will lower a plan sponsor's insurance premiums. It is a factor in determining premiums, he says, but one that remains overshadowed by the issue of employer security exposure, which is the principal driver of premium increases for fiduciary liability coverage. A publicly traded company that holds 30% of plan assets in company stock, he notes, could have premiums 10 or 20 times higher than a privately held company that simply offers a diversified menu of mutual funds.

Sponsors also should choose the service provider that will offer investment advice to their plan participants carefully. Getting this decision right is not as difficult as it was years ago, says Adams, now that big, well-established vendors are in the game. All of the major plan providers are offering advice services to their plan sponsor clients, typically through established advice vendors such as Financial Engines, Morningstar,

Ibbotson Associates, and Guided Choice. However, plan sponsors still need to evaluate their offerings, monitor their performance, and, according to Dallas Salisbury, president and chief executive of the Employee Benefits Research Institute, ensure that the advice provider is capable of producing custom counseling for each plan participant.

Plan sponsors may be safer offering advice, Salisbury says, if the advice process incorporates detailed interviews with participants on their needs, risk aversion, willingness to experience losses, time horizon, other assets, and the ability to save—all leading to very different investment mixes for different participants, with some in all-cash portfolios and others invested heavily in equities. Finally, he says, offering advice is safer if the alternative is a default into a money market account with limited education and little provision of educational tools and seminars. "Like so many other things," he concludes, "it all depends on the facts and circumstances." Balancing the Scales

While there may be no easy answers to the question of whether it is riskier to offer investment advice or not, the weight of expert opinion clearly seems to be shifting in favor of making it available.

"I believe there is very little risk to fiduciaries in the selection and monitoring of reputable advisors for their participants," says attorney Fred Reish, partner and managing director of Reish Luftman Reicher & Cohen in Los Angeles. "On the other hand, I do believe that there is significant risk for fiduciaries where large numbers of participants are investing imprudently." Given that ERISA requires fiduciaries to be prudent, he argues that they would be well served by continually trying to improve the investment services and results offered to participants. "While ERISA does not require that the fiduciaries utilize any particular service in order to satisfy the requirements that they act prudently," he says, "it seems clear that investment advice is one of the arrows in the fiduciaries' quivers."

PICKING A PROVIDER

If electronic methods have robbed the search process of some of its personal feel, the search for an advisor nonetheless requires a good deal of research - a process made easier by databases of advisors and providers, claims Tony Franchimone, PRP, Managing Partner, DFI Advisors, National Retirement Partners. He added that by using databases to narrow down the list of providers, plan sponsors create a process that can be documented, fulfilling due diligence requirements.

Fellow panelist Paul Powell, PRP, SVP at CapSouth Partners urged plan sponsors to map out goals and objectives for the plan before going to advisors. He likened the tendency of some plan sponsors to go in blindly to getting into a taxi cab and saying drive, not giving an address - and then being surprised when they wind up in a place they didn't desire. Each year, the plan sponsors need to see if their established goals have been met, and perhaps shift those goals around, if appropriate, he added.

Picking the Committee: Overall Advice

When a company chooses a committee to oversee the provider search process and come up with objectives for the plan, they should choose people "on a sophisticated level," said Fred Reish, Managing Director, Reish Luftman Reicher & Cohen. Reish said that simply appointing people to these committees that have no management experience and no sense of financial investments is not prudent.

Reish said that if a company's fiduciary decisions are in question in court, plaintiffs' lawyers might zero in on the fact that a committee appointee has no credentials or apparent reason to be on the committee. He warned to steer clear of appointing people in the company to the committee to have a representation from the rank-and-file.

Reish added that large companies should also have a general counsel to speak on legal implications of decisions, but the counsel should not be on the committee, just in the room.

Putting together a committee comprised of employees savvy enough to hold up to an ERISA court's standards is not an easy task for a small company, where there are only a few top level managers that would pass muster, admitted Reish.

ClearPoint Financial

Paul Grutzner · Michael Brown
Daphne Smith · Jackie Ott
Gary Giffen · Jim McDonald
Peter Carpenter · Kevin Overbey
Kerr Bacchus

**720 Olive Way, Suite 1700
Seattle, WA 98101
(206) 962-2000**

**Boston: (617) 965-1795
Minneapolis: (612) 373-7040**