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## NRP OFFERS HELP WITH SECTOR FUNDS

 The 401kWire

Tuesday, October 10, 2006

Retirement-focused advisors are getting more information to help them understand sector-based investments. National Retirement Partners, a Capistrano Beach, California-based national retirement plan advisory firm rolled out research on the investments this week, according to Robert Francis, executive vice president of business development.

"With our new research, our advisors can now review and evaluate an entire set of different sector-based investments on a consistent

basis that is within the framework of our existing methodology," explained James Kitchens, chief investment officer for the firm. He added that the information is intended for use by investment advisors with their plan sponsor clients and covers investments such as technology funds, energy funds, and healthcare funds among other sectors.

"All too frequently sector-based investments are not reviewed along with the other plan investments, and we felt that 'N/A' was an inadequate way of treating this issue," Kitchens added.

The reports will be updated on a quarterly basis and posted to the firm's website. NRP currently has 80 member

firms and is developing tools to support those advisors in the retirement space. Those advisors claim more than \$20 billion in assets, according to NRP.

William R. Chetney, NRP's president and CEO said that the new information is a "significant step forward" that demonstrates the firm's belief that thorough research and analysis "core value" and "key component" is its offering.

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## PENSION PROTECTION ACT OPENS NEW DOOR TO ADVICE

**August 15, 2006 (PLANSPONSOR.com) - While the Pension Protection Act passed covers a wide range of issues, perhaps none is of as immediate concern to defined contribution plan sponsors and retirement plan advisors as the provisions on investment advice.**

"I am particularly pleased the bill includes a key issue I've been working on for some seven years: increasing worker access to sound investment advice," noted House Majority Leader John Boehner (R-Ohio) after the bill's passage by a 279-131 vote. "Long before the Enron crisis exposed the glaring lack of professional investment advice available to employees in

the workplace, we conducted hearings that demonstrated the need for this type of advice."

Under the bill, only qualified "fiduciary advisers" fully regulated by applicable banking, insurance, and securities laws may offer investment advice, and that advice must be prudent, objective, and for the exclusive purpose of providing benefits to the plan's participants and beneficiaries.

### Liability Limits

Plan sponsors will remain responsible for prudently selecting and reviewing advice providers, while the advisers themselves will be personally liable for the advice they give. Regarding specific advice, the bill requires that any

purchase or sale occur solely at the direction of the advice recipient; that the compensation received by the fiduciary advisor and affiliates in connection with the sale, acquisition, or holding of the security or other property be reasonable; and that the terms of any purchase or sale of a security are at least as favorable to the plan as an arm's length transaction would be.

Additionally, under the agreement, fiduciaries for employer-sponsored plans that provide investment advice may tailor their recommendations to an individual's own unique needs based on a proprietary computer model that takes into account the personal and

## PENSION PROTECTION ACT OPENS NEW DOOR TO ADVICE (CONT.)

subjective criteria about their financial and family circumstances. However, that model must be certified and audited by an independent party, and the advice must be provided in a manner that is "not biased in favor of investments offered by the fiduciary advisor or a person with a material affiliation or contractual relationship to the fiduciary."

If the participant first receives recommendations from the computer model but then wishes to seek advice directly from the adviser, he or she can request specific advice from the adviser without the use of the computer model.

Investment advisers who breach their fiduciary duty will be:

- Personally liable for any failure to

act solely in the interest of the worker;

- Subject to civil and criminal penalties by the Labor Department;
- Subject to civil lawsuit from the worker;
- Subject to additional excise tax from Internal Revenue Service.

However, protections under federal and state laws regulating individual industries still apply.

Qualified advice providers must disclose in plain, easy-to-understand language any fees or potential conflicts. That disclosure must be made when advice is first given, and at least annually thereafter. It must also be made whenever the worker

requests the information, and whenever there is a material change to the adviser's fees or affiliations.

The bill also notes that employers are not obligated to offer advisory services, nor is any employee under any obligation to accept or follow any advice.

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## RISING RATES MAY RAISE FIDUCIARY EXPOSURE



Friday, September 15, 2006

Does a rising interest rate environment create special risks for plan fiduciaries? National Retirement Partners takes a stab at answering that question in a just-released white paper. The paper is authored by Robert Francis, who joined the firm earlier this year as its chief operating officer.

The paper addresses the impact that quickly rising short term interest rates could have on the stable value option offered by many plans. In the past, there have been concerns that participants would arbitrage between money market funds and stable value funds

as the relative interest rates between the two options changed.

For much of the decade, arbitrage has not been an issue since stable value funds have paid well above short term money market rates. That has changed in the past two years as the Fed raised its Fed Funds rate 17 times to 5.25 percent.

The biggest fiduciary risk for plan sponsors, says Francis, is plans could be exposed to large market value adjustments under the terms of their contracts if they were to remove the option from their plan. That could happen in the instance of a plan changing bundled providers, for example. While participant driven events are typically given at book value, changes initiated by the plan sponsor could trigger

a market valuation under the contract.

That event would likely lead to a large hit in the fund based on the sharp recent increase in shorter term rates.

In addition, some contracts trigger market value adjustments if there are large redemptions from the option. According to Francis those thresholds may be triggered when as little as 10 percent of the fund is moved, or as high as 50 percent.

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## CHALLENGES RAISED BY STOCK MARKET VOLATILITY, CORPORATE SCANDALS

During the late 1990s, all stock market investors – including 401(k) plan participants – seemed to have the Midas touch. So far the current decade has proven to be more challenging for all investors, be they amateurs (like most 401(k) participants) or seasoned professionals. But corporate scandals and the stock market's ups and downs have created new challenges for

401(k) plan sponsors and fiduciaries as well. The 2005/2006 edition of Deloitte's Annual 401(k) Benchmarking Survey ("Survey") – conducted by Deloitte Consulting LLP, the International Foundation, and the International Society of Certified Employee Benefit Specialists – indicates plan sponsors and fiduciaries are rising to these challenges by offering a

diverse variety of investment options, regularly evaluating and benchmarking the performance of their plans' investments, and replacing funds that perform poorly.

**Investment Options**



## CHALLENGES RAISED BY STOCK MARKET VOLATILITY, CORPORATE SCANDALS

The number of investment choices available to the average 401(k) plan participant is 17, up from 15 in 2004. A majority of Survey respondents offer the following core investment options to their plans' participants:

- Actively Managed Domestic Equity (88 percent)
- Actively Managed Global/International Equity (84 percent)
- Stable Value (83 percent)
- General/Core Bond (79 percent)
- Traditional Balanced (69 percent)
- Passively Managed Domestic Equity (62 percent)
- Money Market (58 percent)

Beyond these options, significant numbers of 401(k) plans are expanding their offerings to include time-based lifestyle funds (44 percent). These funds gradually change their focus from growth to principal preservation as the target retirement date nears in order to protect near retirees from short-term stock market fluctuations. Risk-based lifestyle funds, which are being offered by 31 percent of 401(k) plans, also are common. Other popular options include passively managed global equity funds (32 percent), emerging market funds (31 percent), real estate funds (18 percent) and sector funds (15 percent).

Slightly less than one-third (30 percent) of Survey respondents make employer stock available as an investment option to 401(k) plan participants. However, only 12 percent of Survey respondents match employee deferrals in employer stock, down from 15 percent in 2004. Also, of those plan sponsors who match participant contributions in employer stock, more than two-thirds (68 percent) permit participants to reallocate those matching contributions to other investment options immediately.

A small but growing number of 401(k) plans are offering Treasury Inflation Protected Securities (TIPS), which feature an inflation-protected guaranteed rate of return.

According to the Survey, 9 percent of 401(k) plans now offer TIPS, up from 3 percent previously.

In the interest of giving participants maximum flexibility, some 401(k) plans

offer brokerage "windows" which entitles participants to invest in any stocks and/or mutual funds. The Survey indicates 17 percent of 401(k) plans offer self-directed brokerage windows, and 12 percent offer mutual fund only windows.

### Selecting and Monitoring Investment Options

Selecting investment options for 401(k) plans is a fiduciary act under ERISA. Most plans have formal written procedures in place regarding fund selection (78 percent) and formal written investment policies (83 percent) to guide fiduciaries as they carry out their duties.

Of course, fiduciary obligations do not end with selecting investment options. Fiduciaries have an ongoing responsibility to monitor those investment options and make changes as needed. More than half (58 percent) of the Survey respondents evaluate and benchmark the performance of their plans' investments on a quarterly basis, 14 percent do so semiannually, and 22 percent do so on an annual basis. The rest use another schedule (1 percent) or do not have a formal schedule (5 percent). Two-thirds of Survey respondents have internal committees responsible for monitoring investments. But 55 percent of respondents reported using an outside investment consultant, and 38 percent reported using their plan recordkeepers, to at least help with this function.

### Dealing with Underperforming Funds

Almost two-thirds (66 percent) of Survey respondents indicated they handled underperforming funds by replacing them. In fact, more than half (57 percent) said they have replaced a fund due to poor performance during the past two years and 76 percent have done so within the last five years. However, almost one in five (19 percent) respondents never has replaced a fund due to poor performance.

Other approaches to handling underperforming funds include continuing to monitor the funds (51 percent), adding additional funds with the same investment style (17 percent), freezing the funds (16 percent), and phasing out the funds over a period of time (15 percent).

### Investment Advice

It is one thing for 401(k) plan sponsors to make sure participants have sound investment options to choose from, but quite another for them to make sure participants have the skills and resources to make sound investment decisions. According to the Survey, 38 percent of respondents make individual financial counseling/investment advice available to all participants and another two percent make this service available to some participants. Another seven percent are in the process of implementing an individual financial counseling/investment advice feature. But 53 percent do not offer this service at all, primarily due to concerns about potential fiduciary liability and cost. However, of those who do not offer individual financial counseling/investment advice, 34 percent cite lack of employee interest as one of their reasons.

### About the Survey

A total of 830 401(k) plan sponsors from a broad spectrum of industries participated in the Survey. The respondents do not represent a random sample of 401(k) plan sponsors, so the results cannot be projected to all plan sponsors. However, the Survey offers a highly detailed snapshot of the policies, features, objectives, and expectations of the respondents and the people who manage the respondents' 401(k) plans.

From the July 31, 2006 issue of [Deloitte's Washington Bulletin](#)

## JUST OUT OF REISH: FIRST THINGS FIRST

### First steps in building that 401(k) investment menu

The first step in selecting investments for a 401(k) plan is to evaluate the needs of your plan and your participants. The number and types of investments, as well as the investment services, should be "prudent and suitable" for your employees to use effectively for accumulating retirement benefits. One size does not fit all—in the sense that there is no one investment menu that is appropriate for all plans and all groups of employees.

The second step is to determine the number and types of "asset classes," or investment categories, to be included in the plan. A plan should offer a "broad range" of investment categories to allow participants a reasonable opportunity to balance risk and reward through their investment selections. While there is not a mandated set of categories, some investment experts believe that at least six "core" options are needed—for example, US large-cap growth stocks, US large-cap value stocks, US small-cap blend stocks, international stocks, US bonds, and stable value (or money market).

While investment experts may differ on the minimum number of categories and the specific types of categories, it is clear that 401(k) fiduciaries have the responsibility to pick a lineup that offers the types of investments necessary to allow participants to balance risk and reward properly in their accounts. (A recent academic study selected eight investment categories as its benchmark for the proper combination of investments for this broad range requirement.

A plan can offer investments in addition to those in the core categories, but it is not required to do so. In deciding which noncore

categories to include, fiduciaries should consider whether their employees have the investment abilities to understand the - additional choices and to use them - properly. If not, the fiduciaries need to decide whether they are willing to make the additional effort to provide investment education, investment advice, or other services needed to compensate for that lack of knowledge.

If the accumulation of retirement benefits is the primary purpose of 401(k) plans—which it is, by law—it would seem imprudent to offer investments that participants have little chance of using successfully and that, if misused, could result in significant losses and inadequate retirement benefits.

Having set upon the broad categories, the next step is to decide how to populate those categories with specific investments—for example, mutual funds. In doing that, there are questions to be answered. Should each category include only one fund—for example, should the large-cap growth category consist of only one large-cap growth mutual fund? If participants lack the knowledge to choose properly among competing large-cap growth funds, the answer is obvious. Fiduciaries can compensate for lack of participant knowledge by providing services to educate employees about how to distinguish among funds in the same category but, in most cases, by offering multiple choices within a single category, plans run the risk of confusing employees and making the investment process more difficult.

The next step is to choose the criteria for selecting the individual funds to fill the investment categories. That involves both

qualitative and quantitative factors. Quantitative factors include criteria such as historical performance, expense ratio, volatility, consistency of performance, turnover, and so on. Qualitative criteria include factors such as tenure of the manager, stability and reputation of the organization, and ethics and culture of the management company.

After the investment categories are determined and the mutual funds have been chosen, the fiduciaries (e.g., the plan committee members) should review their work and decide what is needed for the participants to use those investments successfully: education, advice, professional management, lifestyle or lifecycle funds, asset allocation models, and so on. The fundamental question is not whether to offer those services, but to determine which actually will result in the participants being well-invested. Features and services are attractive, but results are essential.

If the fiduciaries follow this process, they will have fulfilled their ERISA responsibilities to select prudently the investments for their plan. The first step is done; the next step is to monitor their decisions to make sure they actually are working to produce retirement benefits.

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

720 Olive Way, Suite 1700  
Seattle, WA 98101  
(888) 557-6471

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

