

IMC Article 3 – The “What you get for what you pay for” 401(k) Proposition

How do you measure success, how is the 401(k) industry doing in general, and what is worth paying more for?

Introduction

- o IMC has compiled a list of 21 key elements of importance for defined contribution plans. This list, and associated industry expert assessments, was built from the data findings of 5 separate IMC conducted surveys occurring between 2002 and 2006.
- o Respondents to the surveys were generally asked for two kinds of feedback, 1) How do you think DC plans in general are doing relative to the items in question? And 2) in their judgment does achieving a superior result related to a given item justify a premium price?
- o As is the case with all IMC surveys, respondents were asked for their opinions and not for those of their company. No questions were asked about specific competitors. This approach has historically led to increased participation and more authentic and candid feedback.
- o The survey results presented here provide the consensus answers given us by over 70 different DC industry experts from our recordkeepers and consultant/advisors survey groups.
- o This candid and insiders' view expands the conversation on 401(k) to value for cost.

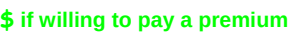
Notes on IMC Surveys 2002 through 2006

The source information presented captures data, findings, and context from each of IMC's last five surveys – most recent opinions on a given subject are illustrated.

Survey scales varied by survey – asking for A-F letter grades, 1 to 10 importance rating responses, and which statement best describes your opinion. To present the information in this article on a uniform basis, all responses have been aligned (and converted where necessary) to our statement and level of agreement approach.

IMC's surveys have over the years been used exclusively by industry insiders to brainstorm and prioritize improvements and innovations, and to separate today's headlines from real developing trends.

21 items of importance to DC plans

Key  Obtaining very outstanding results  Acceptable, but could be better  \$ if willing to pay a premium
 Obtaining good results  Falling short of the mark

		Experts' Assessment		Worth paying more for?	
#	401(k) products, services, and outcomes	Recordkeeper	Consultant	Recordkeeper	Consultant
1	Investment Structure			\$	
	The basic principles of designing and communicating investment choices in tiers - that match up with the delegator, doer, and sophisticated investor - are well known. How has the industry done in executing investment structure?				
2	Investment Core Menus			\$	\$
	Overall, how have DC plans done in offering a variety of investment choices (asset classes, vehicles, active and passive) that combine to make productive portfolios for low risk, to more comfortable with risk, plan participants?				
3	Appropriate Asset Allocation			\$	\$
	How well have DC plans done by way of measuring the diversification, long-term (sticks with strategy), and age appropriateness (weighting to stocks and bonds) asset allocations of their participants?				
4	Risk and Target Date Choices				
	Today's single choice diversified portfolios have real investment merit, composition and cost reflective of an appropriate institutional solution, and are being intelligently considered by plan sponsors and communicated to participants.				
5	Managed Accounts				
	Today's managed account (as currently executed) represents a value added improvement over institutional target date retirement choices and is worthy of paying extra money to receive.				
6	Retirement Income			\$	
	How is the industry currently doing at testing, building, and rolling out communications and investments aimed at meeting the short and long-term individual participant needs for lifetime family income?				
7	Plans with Company Stock				\$
	How well has the industry done in openly discussing, devising and implementing strategies to facilitate investment diversification, short of a regulatory mandate?				
8	Communications and Participant Education			\$	
	Industry standard approaches engage the wide variety of eligible employees to thoughtfully, and in time, chart out a financial course and investment program that makes sense based on a combination of their specific circumstances and priorities.				

How do you measure success, how is the 401(k) industry doing in general, and what is worth paying more for? – Part 3 in a Series of 5
Investment Management Consultants, Inc. 111 SW Columbia, Ste. 1080, Portland, Oregon 97201, 503-248-9064 – Ron Eisen, President reisen@imc-inv.com

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9	Participants Formulate Initial and Ongoing Financial Security Goals			\$	
	The industry does a good job of helping every employee to establish a starting goal and course of action, and then engages employees to take action and as appropriate, establish subsequent goals and objectives.				
10	401(k) Plan Participant Touch Points			\$	\$
	The industry's print material, web tools and information, VRU, phone reps, and in the field workshops, provide easy access to what individuals need to get started in and to manage their 401(k)s.				
11	Local Face to Face Workshops and Individual Participant Meetings			\$	
	Workshops have terrific current topics, are presented well, and draw many attendees; and, one-on-one meetings are offered that really help participants to weigh their options and make good decisions.				
12	Participation and Deferral Levels			\$	\$
	Are recordkeepers and plan sponsors implementing easy to understand and act upon approaches that are increasing participation rates and deferral amounts?				
13	Income Replacement Rates			\$	\$
	The industry is fast approaching the achievement of a high percentage of 401(k) participants being on time to having their 401(k) replace 70% or more of their earnings by retirement age.				
14	Fiduciary Management and Supervision			\$	\$
	The standard fiduciary management controls and approaches offered to plan sponsors by ERISA attorneys, recordkeepers, and consultant/advisors have kept most plans in the main channel and safe from harm's way.				
15	Transparency and Vetting of Conflicts of Interest				
	Recordkeepers and plan sponsor advisors have been forthright (without being asked) about sources of revenue, reasonableness of compensation for services rendered, and the open vetting of any areas where a conflict of interest <u>may</u> exist.				
16	Reasonable Costs and How to Pay for Recordkeeping				
	Plan sponsors understand how <u>they</u> pay for 401(k) services, how much they pay, how much is reasonable, and how to affect changes when warranted.				

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17	Distributing Costs – Cost Fairness				
	The industry in general has paid attention to making sure costs are being borne fairly so that no one group of participants is, to their detriment, subsidizing base plan services costs for another group.				
18	Recordkeeper Consultativeness			\$	
	Plan recordkeepers attempt to make their service fit plans and participants, as opposed to practicing in ways that in effect ask plans and participants to change to conform to what the recordkeeper would prefer to provide.				
19	Outsourcing Services Provided			\$	\$
	Overall, recordkeepers provide administrative outsourcing services for retirement plans, and in some cases health and welfare as well, that is reliable and both time and cost saving to employers and employees.				
20	Service Standards Achieved				
	The vast majority of today's DC plans operate at timeliness and accuracy standards that meet the needs of plans and participants.				
21	Next Generation Retirement Communications and Education			\$	\$
	Today's DC plan education and communication programs are in sync with and incorporate what we have learned on aging, how long we will have to <u>or</u> want to work, "sandwich" challenges, well being as we age, and phased retirement thinking and planning.				

Are responses typical across the entire industry?

- o Based on feedback from our surveys' expert respondents, the information presented in this article is reflective of the job being done for the vast bulk of plans across all market segments.
- o Industry best practice results would score "good to outstanding" depending on the area in question. At present, these experts believe 1 in 10, or at most 2 in 10, plans receive this level of service.
- o Is there a common denominator among plans operating at the industry best practice level? Yes, the common denominator is the plan sponsor. These plan sponsors are far more specific on what they expect, and manage their relationships on a continuous basis to the expectations.

Conclusion

Thinking about the nature of the surveys' subject matter, and the respondent assessments, serves to remind us of the importance of these plans to individuals and to our society as a whole.

While there is no doubt that market force and PPA driven cost reductions, more one stop investment approaches, and improvements in participation and deferral rates from auto designs are coming into 401(k) – we ask a great deal more from these retirement programs than what these important enhancements will produce.

These recent improvements will do a lot to simplify 401(k), facilitate more personal responsibility, and minimize poor decision making. However, due to the absence of mandatory or even optional life finance curricula in K-12 and family circles – 401(k)'s are expected, possibly single handedly, to get our attention and teach us, and/or correct our habits, in ways that result in financial security. Here, lower costs are not the silver bullet.

In fact, innovating and implementing the practices that will create the wide spread and adequate income replacement ratios that 401(k) aspires to, will require considerable money be spent by service providers on personal communication and in-person education. Further, the achievements we target will require continuous, ongoing involvement with plans and participants. Not every strategy worth trying will work, and no single approach will work for everyone. This effort, though costly, is of paramount importance.

Across the DC industry, retirement plan services are paid for through a number of approaches falling into 2 camps: those having a variable revenue stream and those having a fixed revenue stream. The use of revenue sharing dollars from investments is the industry's most common approach and provides a variable and over time increasing source of revenue to the recordkeeper. When this revenue stream is fully accounted for and reasonable, sourced from appropriate cost and consistent performance investments, and spent productively, it supports the resources necessary to aspire to better participant outcomes. Without checks and balances, the benefit is less clear. Fixed revenue approaches have the same opportunity to enhance services overtime through the injection of additional resources, but often face constrained benefits budgets in no small part owing to rising healthcare costs, making it more challenging to do so. For all approaches, a balance between costs and value must be reached, resulting in the services needed for real progress toward participant income replacement to be attained.

The survey findings we've presented clearly show that means are available for plan sponsors using revenue sharing arrangements to take back excess revenues. The companion to this "best practice" is to establish realistic and tangible success standards and to require accountability. In this case, plan sponsors are managing both the cost and value proposition.

In Article 4, IMC moves on to discuss retirement in America in the years ahead. We will see that retirement for most of us will be a very different matter than what is popularly accepted, or for that matter, addressed to our knowledge in 401(k)s. For 401(k) benefits to be maximized, plans will need to incorporate these new retirement realities into their communications and education programs.