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Case Study

Plan Fee Benchmarking: Pricing Structure Revisited

Plan fee benchmarking studies are becoming increasingly more important for plan sponsors to fulfill their fiduciary responsibilities. Plan fees directly impact the total potential savings possible for plan participants. Plan fees vary from plan to plan. For such reason, PEI recommends plan sponsors to undergo this practice every three to five years to see what the market has to offer at that given point in time. In doing so, plan fiduciaries act in the best interest of the plan participants. Additionally, plan sponsors increase their fiduciary protection by following a prudent, documented process.

As an example, PEI facilitated a plan fee benchmarking study for a \$180M DC plan with over 1,100 participants. At the start of the project the client was in a bundled pricing arrangement with their incumbent which meant the vendor was collecting all revenue offset from the investment lineup as their fee. At that time the required revenue equated to 18 basis points (bps).

At the beginning of the project, the incumbent was in the process of changing a majority of funds in the plan to lower-cost share classes to reduce overall plan fees; estimated fees would be reduced to 11 bps. As a result of PEI's plan fee benchmarking process, the incumbent came back to PEI with a price quote of 5.5 bps. The marketplace fee quotes provided by the vendors included in this study ranged between 5 and 10 bps.

The end result of the plan fee benchmarking analysis lead to a reduction of \$225,000 in administrative fees.



Investments

Retirement Plan Limits Increase

The Internal Revenue Service (IRS) and the U.S Social Security Administration recently announced cost of living adjustments (COLA). The announcement outlines new limits for retirement plans and other retirement-related items for 2012.

For many of these limits, this is the first increase since 2009.

Sources: Internal Revenue Service. <http://www.irs.gov/newsroom/article/0,,id=248482,00.html>
 Accessed October 28, 2011.
 U.S. Social Security Administration. <http://www.ssa.gov/oact/cola/cbb.html>. Accessed October 28, 2011.

Description of Limit	2012	2011
401(k) Elective Deferral	\$17,000	\$16,500
403(b)/457 Elective Deferrals	\$17,000	\$16,500
Annual Compensation Limit	\$250,000	\$245,000
Annual Defined Contribution Limit	\$50,000	\$49,000
Catch-up Contributions	\$5,500	\$5,500
Highly Compensated Employees	\$115,000	\$110,000
Social Security Wage Base	\$110,100	\$106,800



Case Study

403(b) Consolidation

Many 403(b) plans were initially constructed with hundreds of investment choices across multiple vendor platforms. When the final 403(b) regulations indicated that the level of employer responsibility and involvement with the plan administration would increase, it was clear that 403(b) plans would more closely resemble 401(k) plans in terms of plan design, fiduciary oversight, as well as other contributing factors. Due to the rigorous requirements of the final regulations, many plan sponsors sought to make their plan oversight more efficient through vendor and investment consolidation.

Over the past few years, PEI has worked with 403(b) plan sponsors to help them achieve the benefits of vendor consolidation. The benefits that have been achieved for our clients through this process include:

- Reduced fiduciary risk exposure;
- Improved price efficiency opportunities;
- Simplified monitoring of loans, hardship withdrawals, and other distributions;

- Outsourced additional administrative functions that were traditionally retained by the plan sponsor;
- Improved investment oversight with a comprehensive, and more manageable fund lineup; and
- Greater efficiencies in plan reporting.

Participants were also positively impacted. Such results include:

- Simplified processes with single provider enrollment, education, and communications;
- Greater ease in completing transactions and understanding of the investment menu choices available;
- Improved planning tools with a single statement with their complete plan picture and personal rate of return; and
- New ability to invest in cheaper share classes.



Investments

PBGC Investment About Face

Back in 2008, The Pension Benefit Guaranty Corporation (PBGC) altered their investment allocation from a 75%-85% fixed income /15%-25% equity allocation to a more aggressive allocation of 45% equity, 45% fixed income, and 10% alternative investments in order to generate higher returns over the long-term. One of the reasons for the change was the PBGC deficit of \$11.2B. The timing of this change could not have been worse as equity markets had a steep decline in late 2008. That same date in 2010 the organization reported a \$23B deficit. This was originally met with scrutiny from the House Education and Labor Committee because of the large losses and increased volatility of equities at that time. It appears that PBGC has decided to revert back to a conservative lineup, and updated their investment policy in May 2011 to reflect a new target allocation of 30% in equities and other non-fixed income asset classes (which include US REITs, real estate, private equity, and other limited marketability assets received from terminated defined benefit plans), and 70% in fixed income.

Currently, the PBGC offers companies with pension plans an annual flat-rate premium of \$35 per plan participant, and a variable-rate premium of \$9 per \$1,000 of the defined benefit plan underfunded. These rates have remained relatively unchanged over the past few years, with the annual flat-rate premium rising to \$35 from \$33 in 2008, and the variable-rate staying the same since 2008. In October, 2011, the PBGC announced that the flat-rate and variable-rate premiums will remain unchanged for another year in 2012.



PEI News

On September 27, Fred Stewart, Managing Director—Southeast Region, moderated a discussion on the 401(k) disclosure rules at the 2011 Southern Employee Benefits Conference (SEBC). The event took place in Atlanta, Georgia.

Principal Attila Toth facilitated a panel discussion, “What’s the Right Standard?”, at the PLANADVISOR National Conference in Orlando, Florida in September. Attendees reviewed tools and standards to properly benchmark a defined contribution plan.

Fred Stewart moderated the, “Business Development for the Next Decade”, discussion session. This panel shared comments concerning the best practices in social media and blogs.



About

Portfolio Evaluations, Inc. is a privately-owned institutional investment consulting firm. Founded in 1992, PEI operates in an independent, non-affiliated capacity to provide advice, guidance, direction, and education to the fiduciaries of institutional investment programs. Our independence allows us to serve our clients in a manner that is free from influence from investment management firms, mutual fund companies, broker-dealers, insurance companies and other industry professionals.



Trend Outlook

Participant Activity Since the Economic Downgrade

In early August of 2011, Standard & Poor's (S&P) downgraded the long-term debt of the U.S. government from the top AAA rating to AA+. To gain an understanding of how participants reacted to the downgrade, PEI conducted a survey of retirement plan providers. The providers were asked to disclose statistics on call center activity, website activity, and overall plan activity with participants either reallocating their balances, changing their elections or making no changes at all. Six providers responded to our request.

“...they did not see participants making drastic changes to either asset allocations and/or future investment elections within their retirement plans.”

The majority of providers indicated they saw increases in call volumes and website activity, however, they did not see participants making drastic changes to either asset allocations and/or future investment elections within their retirement plans. Call volume statistics ranged from no reportable increase to an increase as high as 40%. Website usage statistics ranged from an increase of 8% to over 35%.

The solutions given for dealing with the higher call volumes varied by provider and are as follows:

- canceled all non-essential off phone activities; enlisted former phone representatives;
- adjusted staffing levels to ensure sufficient coverage, including mandatory overtime, deferred vacation, reductions in lunch/break times, having managers on the phones; and
- enlisted all associates, including supervisors and those not currently accepting calls.

Participants asked questions focused mainly on how they should be reacting to the downgrade, moving toward safer investments and generally just wanting to understand what was going on with the markets. The most common message given to participants by the providers was that retirement planning is for the long-term and they should make sure they understood the risk associated with their current investment portfolio before making any changes.

Overall, the providers surveyed stated they did see some increase in transactional activity of assets being moved from equities to safer investment alternatives but at the most this only represented approximately 2% to 3% of their overall participant population. Most participants opted not to make any changes to their retirement plan given the downgrade.



PEI Calendar

PEI Speaking Engagement
November 2, 2011
Philadelphia, PA

David Hudak, will speak at the PSCA's 2011 East Coast Regional Conference in Philadelphia. The event will host plan sponsors and industry experts for a series of informational sessions.

David will speak on the important topic of, “What You May Not Know About Your Investment Advisor”.



Interim Policy on Electronic Disclosure

In early September the DOL announced an interim disclosure policy to allow for electronic delivery of participant fee disclosures. The ability to furnish plan fee disclosures via electronic media can lower costs and increase timeliness and accuracy. Although this policy is not a final ruling, it does come with restrictions and considerations.

Plan participants need to have the ability to effectively access the disclosure documents in their electronic form from locations where the participant is expected to perform his or her duties as an employee. For other participants (such as former employees, retirees, and those who do not actively have access to a computer to fulfill his or her duties), beneficiaries, and other persons entitled to the disclosure rules, consent must be given to receive these communications via electronic media. Also of importance, the employer must provide the ability for the participant to request, free of charge, a print copy of any disclosures.

The plan fee disclosure rule for plan participants takes effect in 2012. Plan sponsors need to be sure that each of the below qualifications are met to be in compliance with the interim electronic disclosure policy.

- Participants and beneficiaries need to voluntarily provide an email address.
- Electronic messages must contain specific sections including clear directions on how to update an email address and the right to opt out of receiving electronic communications.
- An annual message must be sent to confirm the acceptance of email messages.
- Plan administrators need to take appropriate measures to ensure delivery of electronic messages.
- Plan sponsors need to take appropriate actions to ensure that the electronic delivery system protects personal information.
- E-communications need to be stated in an easy to understand manner for all recipients.



Archives

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Sources of Income in a Declining Rate Environment

The past few years have showcased an environment of low interest rates for fixed income investments, especially those of higher quality. This challenging climate leads one to ponder where other sources of income might be found. Fiduciaries can look to several other assets, including:

Dividend Paying Equities

Many companies pay a dividend to their shareholders. This payout can be quarterly or semi-annually, and is usually paid by companies that find themselves with a lot of cash on their balance sheets, typically in industries such as energy, financials, utilities or pharmaceuticals. The average dividend on the S&P500 Index is currently 2.15%. Rarely will dividends be paid by technology companies, those with smaller market capitalizations, or others in the early stages of their growth trajectory.

Real Estate Investment Trust (REITs)

REITs are publicly traded companies that invest in real estate. They are required to pay 90% of their income to their shareholders, resulting in dividends for investors.

Direct Real Estate

Investing directly in real estate can produce income in the form of rent. There are many risks associated with this type of investment, including the ability to lease a property, the price the market will bear for the rent, as well as the many costs associated with property ownership.

Master Limited Partnerships (MLPs)

MLPs are publicly traded securities found in the oil, coal or natural gas industries. They are often pipeline companies that transport these natural resources. Investors receive a quarterly required distribution (QRD) which is stated in the contract of the MLP.

Preferred Stocks

Preferred stocks are investments that have characteristics of both stocks and bonds. Preferred dividends are another potential source of income. Preferred stocks will have priority for dividend payments after bonds but before equities



Commentary

The “New Normal”

In February of 2010, *Forbes Magazine* released an article describing the thoughts of fixed income gurus Bill Gross and Mohamed El-Erian of PIMCO regarding what they perceived as a new normal for the U.S. economy. It was stated that the new normal included a lower standard of living, high unemployment, stagnant corporate profits, heavy government intervention in the economy, and disappointing equity returns (Forbes – February 2010).

During good and bad economic times one often hears commentators claiming that “this time it is different”, and it is not just negative shocks that illicit this response.

Positive movements in the market generate a similar rhetoric. This occurred during the run-up in the real estate markets prior to 2007, when many were convinced that the rise in real estate prices were the result of an improving standard of living across the country and that a new normal would be realized and real estate valuations would settle out at a higher level.

Another example is when the technology bubble was building over in the late 1990’s and while some began to recognize that something didn’t seem right, the commentators were saying “this time it is different because the internet is revolutionizing business and putting us into a “new normal” of corporate profitability.” Of course that didn’t play out, and when the bubble did finally burst the commentators were again saying “this time it is different because after getting crushed in 2002, the average investor (which was seen as a big driver of the tech bubble) will never trust the stock market with their money again”, however that the average investor did slowly get back into equities.

Time will tell whether predictions of a new normal will or will not play out, but history has tended to make us a bit skeptical of any argument that begins with the phrase “This time it is different because....”.

This newsletter has been prepared exclusively for informational purposes. Every effort has been made to provide accurate and authoritative information in regards to the subject matter in this newsletter; however, accuracy and completeness cannot be guaranteed and is not warranted as such. Numerous sources were used in compiling the data for this newsletter. PEI does not assume responsibility for the accuracy or completeness of such information. The information contained in this newsletter is provided with the understanding that PEI is not engaged in rendering legal, accounting, or actuarial advice. If such advice is required, the services of a competent professional of this kind should be sought. The information contained in this newsletter does not constitute the recommendation of any advisement advisor or their services nor does PEI assume responsibility for the conduct of any investment manager.

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