Value Standards: The Next Logical Step for our Industry

May 2011
Tom Kmak, CEO
Fiduciary Benchmarks
Remember this?

![Image of a Texaco gas station with cars lined up]

**EPA Fuel Economy Estimates**

<table>
<thead>
<tr>
<th>CITY MPG</th>
<th>18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected range for most drivers</td>
<td>15 to 21 MPG</td>
</tr>
<tr>
<td><strong>Estimated Annual Fuel Cost</strong></td>
<td>$2,039</td>
</tr>
<tr>
<td>based on 15,000 miles at $2.80 per gallon</td>
<td></td>
</tr>
</tbody>
</table>

| HIGHWAY MPG | 25 |
| Expected range for most drivers | 21 to 25 MPG |

*Combined Fuel Economy This Vehicle 21 MPGe All SUVs 31 MPGe*

See the FREE Fuel Economy Guide at dealers or [www.fueleconomy.gov](http://www.fueleconomy.gov)
An Important Value Standard

What is CAFE?
Corporate Average Fuel Economy (CAFE) is the sales weighted average fuel economy, expressed in miles per gallon (mpg), of a manufacturer’s fleet of passenger cars or light trucks with a gross vehicle weight rating (GVWR) of 8,500 lbs. or less, manufactured for sale in the United States, for any given model year.

General Motors announced that it believes its rechargeable, electric-powered Chevrolet Volt will achieve an EPA-rated gas mileage of 230 miles per gallon in city driving. For comparison's sake, the industry leader Toyota Prius only gets a measly 48 miles per gallon.
Other Value Standards for the Auto Industry
Value Standards for Other Industries

• Speed/Quality of Processor
• Disk Storage Capacity
• Ease of Use

• Number of Hospital Days
• Recovery Time
• Probability of Success

• ???
The Balanced Scorecard

- **“Lag” Metrics**
  - *Define* “What is Winning”
  - Typically CANNOT be managed directly

- **“Lead” Metrics**
  - *Predict* “What is Winning”
  - Typically CAN be managed directly
Our Industry’s Value Standard

“What is Winning?

- Performance

“What predicts Winning?”

- People
- Process
- Price
Two Client Constituencies

PLAN SPONSORS

PARTICIPANTS
What is the Press concentrating on?

Press

“60 Minutes”

Are fees draining your 401(k) retirement savings?

Google Search: 401(k) fees too high 528,000 mentions
Helping Participants Retire: Rob or Bob?

Rob and Bob both work in the software business:

- They are the same age: 25
- They both made 401(k) contributions for the same number of years: 40
- They both retire at the same age: 67
- They both contribute the same amount: $2,000 per year
- Each company has the same matching contribution: 50%
- They are both invested in the same fund earnings: 6.09%
  - Rob is invested in the institutional class at a .50% fee
  - Bob is invested in the retail class at a 1.00% fee

So, who will have more money at age 65?

Rob or Bob?
Helping Participants Retire: Rob or Bob?

$1,028,769

$915,082
Participant Success Measures: An Example

1. Based on the assumptions shown on the right, a $40,000 employee that should replace 85% of their pre-retirement income will replace only 77% at retirement.

2. The sensitivity analysis below shows the impact on the 77% wage replacement number by changing each of the factors shown in yellow to the amounts shown in the chart below.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Assumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation</td>
<td>3.09%</td>
</tr>
<tr>
<td>Age</td>
<td>42</td>
</tr>
<tr>
<td>Salary</td>
<td>40,000</td>
</tr>
<tr>
<td>Beginning Balance</td>
<td>-</td>
</tr>
<tr>
<td>EE Contribution</td>
<td>6.00%</td>
</tr>
<tr>
<td>ER Contribution</td>
<td>50.00%</td>
</tr>
<tr>
<td>Earnings</td>
<td>6.39%</td>
</tr>
<tr>
<td>Retirement Age</td>
<td>67</td>
</tr>
<tr>
<td>Annuity Rate</td>
<td>6.00%</td>
</tr>
<tr>
<td>Fees</td>
<td>72 bps</td>
</tr>
</tbody>
</table>

Impact on Replacement Ratio

- Starting Age of 34
- Retirement Age of 62
- Increase EE Contributions to 7.2%
- Earnings of 7.29%
- Annuity Rate of 7.2%
- ER Contribution of 60%
- Lower Fees to .42%
Translating metrics into real value...

The chart below shows the annual impact on a SINGLE PARTICIPANT of changes in several participant success measures. The fact of the matter is that service providers can have a truly meaningful impact on the retirement lives of participants.

<table>
<thead>
<tr>
<th>Participant Success Measure</th>
<th>Change Assumption by 20%</th>
<th>Baseline Dollars</th>
<th>Revised Dollars</th>
<th>Annual Equivalent in Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation Rate</td>
<td>Start age 34 instead of 42</td>
<td>$283,425</td>
<td>$555,245</td>
<td>$10,873</td>
</tr>
<tr>
<td>Preserving Retirement Balance</td>
<td>Rolls over balance at age 38</td>
<td>$283,425</td>
<td>$400,464</td>
<td>$4,682</td>
</tr>
<tr>
<td>Deferral Percentage</td>
<td>Increase from 6.0% to 7.2%</td>
<td>$283,425</td>
<td>$340,110</td>
<td>$2,267</td>
</tr>
<tr>
<td>Percent exercising catch-up</td>
<td>Extra $1,000 per year @ 50</td>
<td>$283,425</td>
<td>$327,234</td>
<td>$1,752</td>
</tr>
<tr>
<td>Maximizing Match</td>
<td>Increase to 60% Match</td>
<td>$283,425</td>
<td>$303,320</td>
<td>$796</td>
</tr>
<tr>
<td>In automatically diversified options</td>
<td>Increase ROR by 50 bps</td>
<td>$283,425</td>
<td>$302,729</td>
<td>$772</td>
</tr>
<tr>
<td>Having a Retirement Goal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Achieving that Retirement Goal</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Priceless
What is Winning?

“What gets measured, gets managed...”

Firms measuring Retirement Readiness:

Peter Drucker, 1909-2005
What Predicts Winning?

- Having a Goal
- Being on Track to Achieve that Goal
What Predicts Winning?

- Participation Rates: Overall, HCEs and NHCEs
- Deferral Percentages: Overall, HCES and NHCEs
- Employees using Auto Escalate
- Employees Maximizing Company Match
- Employees using Catch Up
What Predicts Winning?

- Participants with an appropriate asset allocation
- Participants with a diversified portfolio
- Participants rebalancing those Portfolios
What Predicts Winning?

• Percentage of Participants NOT cashing out
Participant Success Measures: Lag and Lead Metrics

- Knowing
- Saving
- Investing
- Spending
What Predicts Winning? (A deeper look)

70% of workers have not calculated how much money they need for retirement.  
**EBRI 2010**

25% to 30% of workers do not participate in their employer-sponsored defined contribution plan.  
**PSCA 2010**

67% of participants polled assumed asset allocation investments offered some kind of retirement income guarantee.  
**Commonwealth 2009**

85% of participants with balances less than $1,000 cash out their pre-retirement distributions and so do 40% with balances from $1,000 to $20,000.  
**Hewitt 2009**

By almost any measure, it is clear that participants are not properly preparing for retirement, primarily for two reasons:

1. Calculating Retirement Readiness is difficult for most participants.
2. Research has shown that participants will continue to procrastinate on issues that lie in the distant future even if taking action now with minimal sacrifice would dramatically improve their ability to retire securely.
What Predicts Winning? (A deeper look)

This is true despite:
- Millions of participant phone calls
- Millions of dollars spent on brochures
- Thousands of participant meetings
- Numerous internet calculators
What Predicts Winning? (A deeper look)

<table>
<thead>
<tr>
<th>Plan Design Feature</th>
<th>Current Plan</th>
<th>Optimized Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase Participant Deferrals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum Auto-Enrollment Participant Deferral</td>
<td>0.00%</td>
<td>4.00%</td>
</tr>
<tr>
<td>Annual Auto-Escalation Percentage</td>
<td>0.00%</td>
<td>1.75%</td>
</tr>
<tr>
<td>Maximum Automatic Participant Deferral</td>
<td>0.00%</td>
<td>11.00%</td>
</tr>
<tr>
<td>Catch Up Provision</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Optimize Employer Contributions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer Matching Contribution Percentage</td>
<td>25%</td>
<td>15%</td>
</tr>
<tr>
<td>Maximum Matched Participant Deferral</td>
<td>3.0%</td>
<td>20%</td>
</tr>
<tr>
<td>Basic Employer Contribution For All Participants</td>
<td>1.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>&quot;Auto-Pilot&quot; For Novice Investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Offer Qualified Default Investment Alternative(s)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Default All Eligible Participants into QDIA</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Support Services for Intermediate Investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Offer Diversified Core Lineup</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Offer Automatic Rebalancing</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Offer Professional Advice</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Maximum Choice For Advanced Investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Offer Brokerage account or Fund Window</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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What Predicts Winning? (A deeper look)
### Managing the Lead Metrics

<table>
<thead>
<tr>
<th>Participant Success Measures</th>
<th>% Plans Measuring</th>
<th>This Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plan's Current Participation Rate</td>
<td>100%</td>
<td>81%</td>
</tr>
<tr>
<td>Average Deferral Percentage for Non-Highly Compensated Employees</td>
<td>100%</td>
<td>6.7%</td>
</tr>
<tr>
<td>Average Deferral Percentage for Highly Compensated Employees</td>
<td>100%</td>
<td>8.7%</td>
</tr>
<tr>
<td>% of Participants Maximizing Company Match</td>
<td>100%</td>
<td>52%</td>
</tr>
<tr>
<td>% of Plan Assets in Automatically Diversified Options*</td>
<td>98%</td>
<td>36%</td>
</tr>
<tr>
<td>% of Eligible Participants Making Catch-up Contributions</td>
<td>100%</td>
<td>14%</td>
</tr>
<tr>
<td>% of Participants Using Auto-Rebalance Option</td>
<td>8%</td>
<td>5%</td>
</tr>
<tr>
<td>% of Terminated Participants NOT “Cashing Out”</td>
<td>100%</td>
<td>50%</td>
</tr>
<tr>
<td>% of Participants with a Personal Retirement Goal</td>
<td>6%</td>
<td>N/A</td>
</tr>
<tr>
<td>% of Participants On Track to Achieve That Goal</td>
<td>6%</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Two Client Constituencies

PLAN SPONSORS

PARTICIPANTS
## What worries Plan Sponsors

### PLAN SPONSORS

<table>
<thead>
<tr>
<th>Issue</th>
<th>2010</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Everyday administration</td>
<td>31%</td>
<td></td>
</tr>
<tr>
<td>Participant dissatisfaction</td>
<td>19%</td>
<td></td>
</tr>
<tr>
<td>Compliance with DOL regulations</td>
<td></td>
<td>87%</td>
</tr>
<tr>
<td>Enrollment percentages</td>
<td>33%</td>
<td>47%</td>
</tr>
<tr>
<td>Costs/fees</td>
<td></td>
<td>63%</td>
</tr>
<tr>
<td>Investment performance</td>
<td>48%</td>
<td>61%</td>
</tr>
<tr>
<td>Discrimination testing</td>
<td>36%</td>
<td>52%</td>
</tr>
<tr>
<td>Meeting fiduciary obligations</td>
<td></td>
<td>74%</td>
</tr>
</tbody>
</table>

*The Briskin Study of Small Retirement Plan Sponsors, 2010*
Representative Quotes

PLAN SPONSORS

• “Whenever there’s a change in the law...[my provider] sends me an email about it that looks like it was written by lawyers.”

• “I keep on asking our broker how much we’re paying in investment fees and how much commission he’s getting and I never get a straight answer.”

• “All my advisor wants to talk about is fund performance. I can get that online. What I really need is information that can tell us if we’re making the right decisions.”

• “I’ve become so used to phone reps not knowing [anything] that the minute they pick up I tell them to let me talk to someone who does.”

• “After researching on the Internet, I asked our investment advisor to be our ERISA Fiduciary. I’m still waiting for her answer two months later.”

The Briskin Study of Small Retirement Plan Sponsors, 2010
Why Sponsors Change Providers

Top Reasons for Switching Providers:
1. Poor Client Service
2. Substandard Participant Education Services
3. Poor Fiduciary/Regulatory guidance/Support
4. Lack of Fee Transparency
5. Investment Performance Issues
6. Plan Costs Too Expensive

The Briskin Study of Small Retirement Plan Sponsors, 2010
Plan Sponsors

Key points from the 2010 Deloitte 401(k) Survey:

- 62% of plan sponsors feel “that our responsibility includes taking an interest in whether our employees are tracking towards a comfortable retirement”
- Only 15% of surveyed employers believe most employees will be prepared for retirement.
- Employers ranked “improve participant readiness for retirement” as one of the most important changes their providers could make.

Deloitte 2010 Survey
Why Sponsors Change Service Providers

PLAN SPONSORS

Exhibit 10.5. If you have made a change in provider in the last two years, please list the reason for the change (check all that apply):

<table>
<thead>
<tr>
<th>Reason</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>A better solution</td>
<td>46%</td>
<td>56%</td>
</tr>
<tr>
<td>Poor service</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td>Fees</td>
<td>40%</td>
<td>38%</td>
</tr>
<tr>
<td>A change in your organizational structure</td>
<td>16%</td>
<td>20%</td>
</tr>
<tr>
<td>Other</td>
<td>30%</td>
<td>16%</td>
</tr>
<tr>
<td>Provider consolidation</td>
<td>20%</td>
<td>13%</td>
</tr>
</tbody>
</table>

Deloitte 2010 Survey
What are Service Providers measuring?

Deloitte 2010 Survey
What is Winning?

- Are the trains going to run on time?
  - Monitor Service Provider
  - Generate & Evaluate Service Provider RFI
  - Generate & Evaluate Service Provider RFP
  - Support Contract Negotiation
  - Support Service Provider Transition
What is Winning?

■ Am I protected?

• Assess Plan’s Investment Objectives
• Design Overall Structure
• Review QDIA Option
• Review Company Stock Option
• Develop, Maintain & Monitor IPS
• Implement Investment Structure
• Provide & Review Performance Reporting
• Search for New Investment Manager
• Review Plan Governance Structure
• Review 404(c) protection
• Meet with Plan Committee
• Confirm Fiduciary Status
What is Winning?

- Am I getting a fair deal?
  - Ensure all fees are disclosed
  - Benchmark fees AND value for reasonableness
  - Review use of ERISA Spending Accounts
What is Winning?

■ Am I helping my employees prepare for retirement?

  • Review of Education Strategy
  • Provide Group Meetings
  • Provide One-on-One Meetings
  • Provide participant phone/email support
  • Provide Financial Planning Services
  • Provide Participant Newsletter
  • Review Progress against Goals
  • Rending of Participant Advice
  • Build Model Portfolios
What is Winning?

- Are the trains going to run on time?
- Am I protected?
- Am I getting a fair deal?
- Am I helping my employees prepare for retirement?
A tough time to be a Plan Sponsor

Shrinking Budgets

Demanding Employees

Why It’s Time to Retire the 401(k)

$16 million Settlement paid to 401(k) participants
The Value Standards for our Industry

PLAN SPONSORS

Help them manage the various risks they have as a plan fiduciary

OR
The Value Standards for our Industry

PARTICIPANTS → KNOWING

Saving
Investing
Spending

Prove that you can help them achieve Retirement Readiness
Value Standards strengthen an industry

- Did Consumer Reports (founded in 1936) hurt Sony?

- Did edmunds.com (founded in 1966) hurt BMW?

“A big change in the next decade will involve the shift from closed to open communication, says Bob Johansen of Palo Alto, Calif.-based think tank Institute for the Future, which each year makes 10-year forecasts of trends. "Leaders have the choice of riding that wave or bucking it," he said.

Yahoo Finance April 20, 2009
The driver of Value Standards for our industry

- Transparency
- Disclosure
- Reasonableness
- Value

OR
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