

The Economics of Plan Profitability

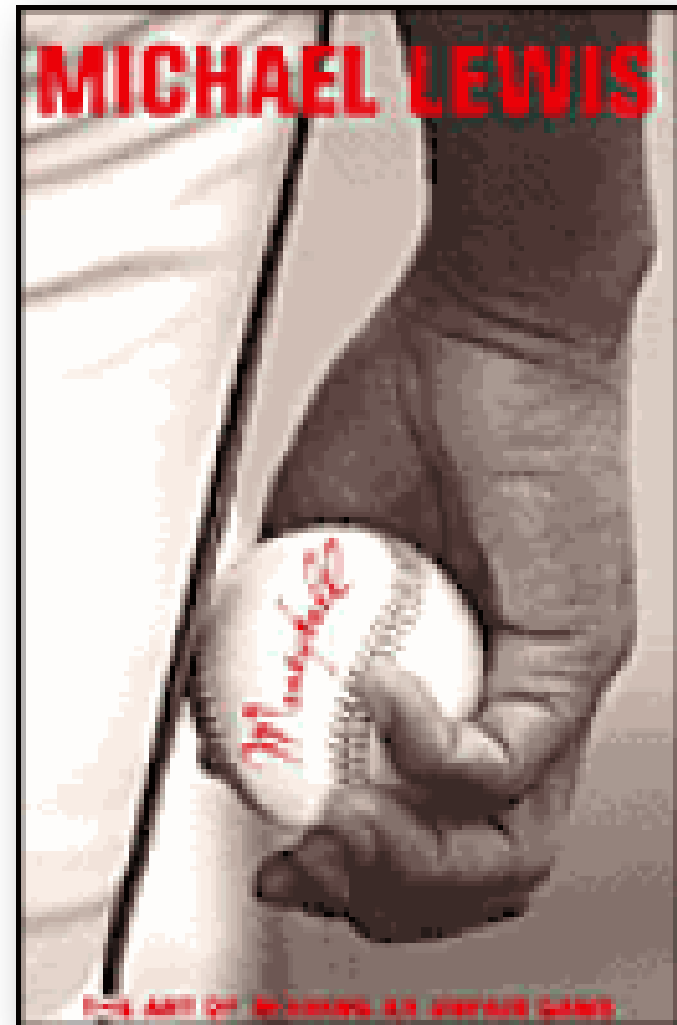
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Agenda

- 1) Defining profitability
- 2) Applying a plan profitability evaluation process
- 3) Managing and enhancing plan profitability
- 4) Practical applications for your retirement plan practice



Adapt or Die: Changing the Competitive Landscape

- What was no longer is
- Breaking through tradition
- If you don't adapt, you will die








Expectations of Retirement Plan Advisors... Survey Says

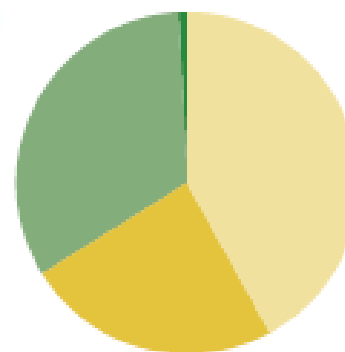
Do you have a written business plan that governs your practice?

	2011	2012	CHANGE
Yes	63.9%	58.4%	-8.6% 
No	36.1%	41.6%	15.2% 

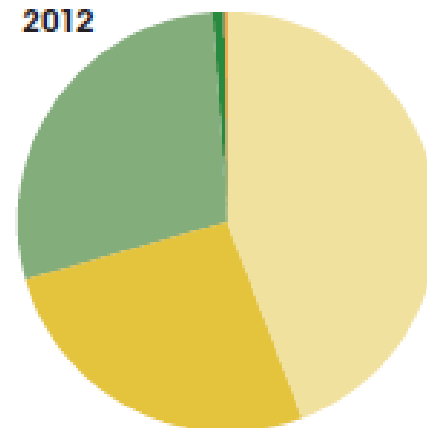
What do you expect to happen to the size of your practice over the next 12 months?

	2011	2012	CHANGE
Stay the same	48.3%	50.2%	3.9% 
Grow in number of advisers	27.8%	30.1%	8.3% 
Grow in number of support staff	37.8%	31.9%	-15.7% 
Decline in number of advisers	0.9%	1.0%	7.3% 
Decline in number of support staff	0.0%	0.2%	n/a 

2011



2012



*2012 PLANADVISED Retirement Plan Adviser Experience Survey

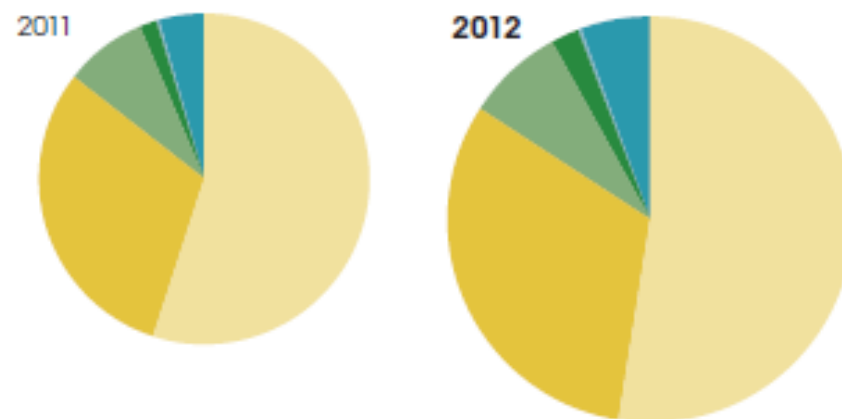
Expectations of Retirement Plan Advisors... Survey Says

What is your top concern for your practice today?

Adding new clients	36.7%	<div></div>
Compliance/fiduciary issues	9.1%	<div></div>
Government regulation	8.0%	<div></div>
Fee compression	7.6%	<div></div>
Practice management	6.3%	<div></div>
Overall economy	6.1%	<div></div>
Profitability	4.1%	<div></div>
Client retention	3.7%	<div></div>
Marketing	3.7%	<div></div>
Participant communication/education	3.5%	<div></div>
Staffing	3.3%	<div></div>
Competition	3.0%	<div></div>
Fee disclosure/transparency	2.0%	<div></div>
Plan sponsor communication/edu	1.7%	<div></div>
Technology	1.1%	<div></div>

What is the exit strategy for your business?

	2011	2012	CHANGE	
No exit strategy plans	55.1%	52.7%	-4.3%	⬇️
Sell to partners/employees	30.5%	31.6%	3.7%	⬆️
Sell to larger entity	8.2%	7.8%	-4.7%	⬇️
Participate in roll-up strategy	1.5%	2.1%	43.2%	⬆️
IPO	0.3%	0.2%	-34.9%	⬇️
Other	4.4%	5.5%	24.3%	⬆️



*2012 PLANADVISER Retirement Plan Adviser Experience Survey

Be Profitable. Be Efficient.

5 Reasons to Assess Plan Level Profitability

- 1) **T**ransparency
- 2) **V**aluation
- 3) **E**fficiency
- 4) **P**ricing
- 5) **C**onsolidation

The ultimate goal of your advisory practice is to make a profit.

.... And not all plan business, is the right business

To Value Each Plan Correctly

Defining Profitability

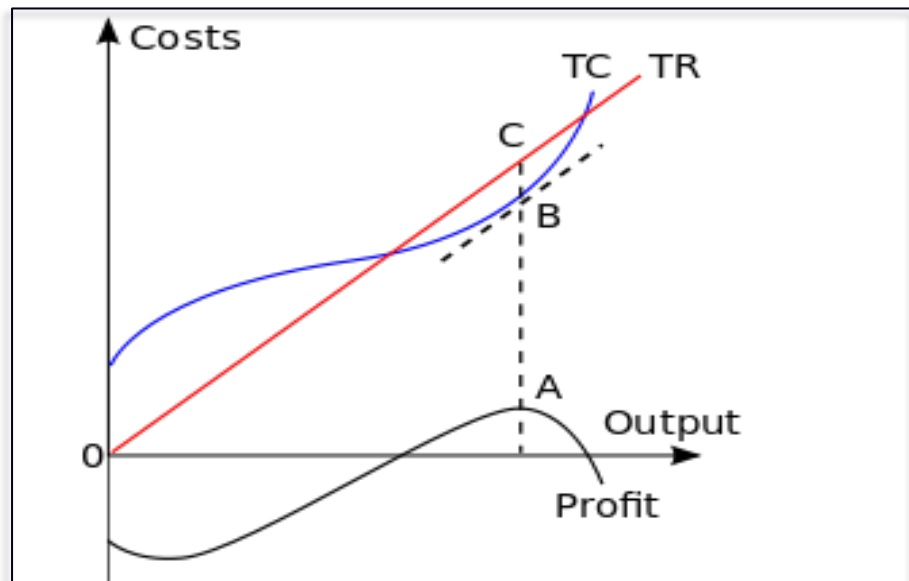
Profit Maximization: The short run or long run process by which a firm determines the price and output level that returns the greatest profit

Two approaches:

1. The ***total revenue – total cost*** approach simply states that profit = revenue – cost and focuses on maximizing this difference
2. The ***marginal revenue – marginal cost*** approach is based on the fact that total profit reaches its maximum point where marginal revenue equals marginal cost

Defining Profitability

$$\text{Total Revenue} - \text{Total Cost} = \text{Profit}$$



TR = Total Revenue

TC = Total Cost

A = Total Profit Curve

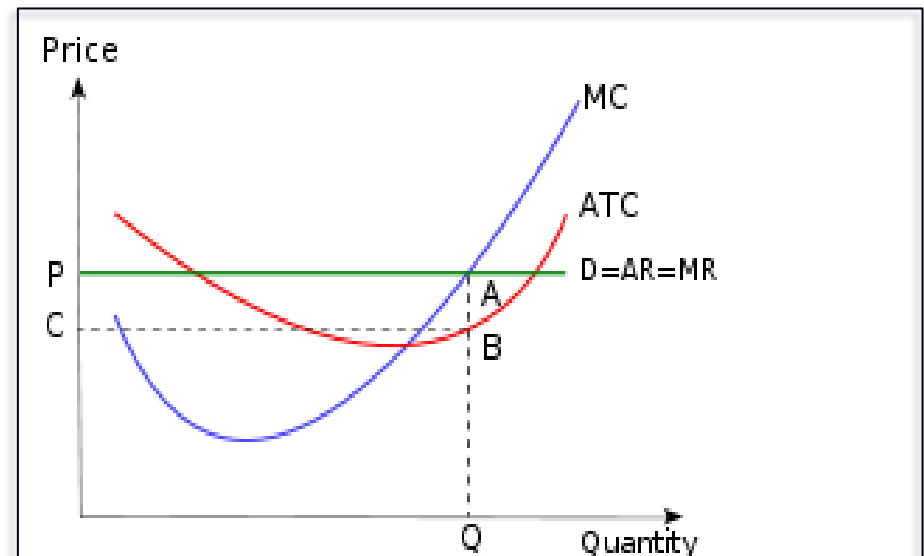
B = Total Cost Curve

C = Total Revenue Curve

Maximum Profit is achieved when

C is \geq B as illustrated by A

$$\text{Marginal Revenue} - \text{Marginal Cost} = \text{Marginal Profit}$$



A = Total Profit Curve
(MR = MC)

B = Total Cost Curve

C = Total Revenue Curve

D = Demand Curve

(AR = MR)

P = Price

Q = Optimum Quantity

MC = Marginal Cost

ATC = Average Total Cost

PABC = Total Economic Profit

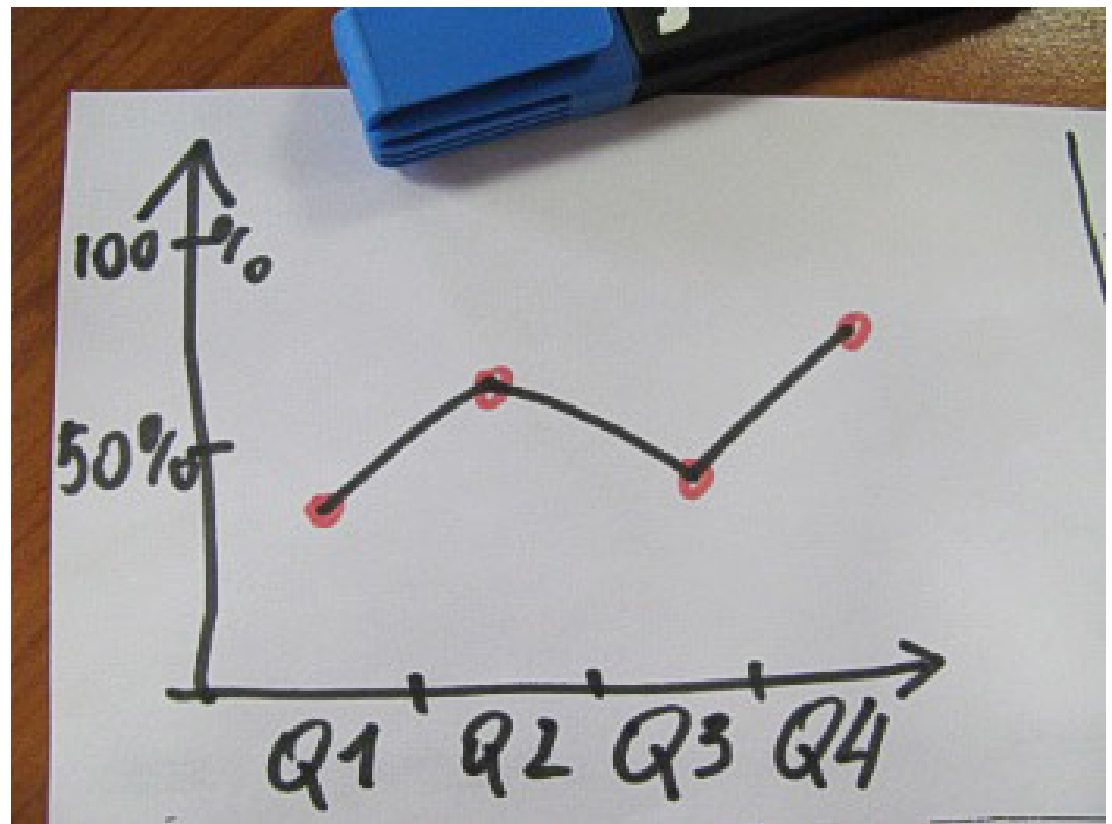
Defining Retirement Plan Practice Profitability

Firm Affiliation:

- Wirehouse
- Independent
- RIA

Business Focus:

- Retirement Specialist
- Wealth Manager



Staying Ahead of the Curve

- Only **1/3rd** of retirement plan advisors know the gross and net margins for their overall DC business, and even fewer (about **1/5th** of retirement plan advisors) know this on a plan-by-plan basis

Retirement Advisors	Gross Profit by DC plan Serviced	Net Profit by DC plan Serviced
I know it well	31%	21%
Don't know, but would love to	33%	37%

**Source: H&W/Sway Research 2012 Retirement Advisor Survey*

Applying a Plan Profitability Evaluation Process

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graph LR; A[Evaluation of Asset, Revenue and Cost Characteristics] --> B[Anticipated Profitability of 1, 3, 5 year Periods]; B --> C[Plan Pricing and Service Model];
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**Evaluation
of Asset,
Revenue
and Cost
Characteristics**

**Anticipated
Profitability of
1, 3, 5 year
Periods**

**Plan Pricing
and Service
Model**

Determining Revenue Sources

Revenues

- Current plan assets
- Number of eligible participants and actual participants
- Salary deferrals and projected annual contributions
- Potential to increase contributions through enhanced education or advice services
- Matching or profit sharing contributions
- Additional services:
 - Education and enrollment meetings
 - Fund selection and monitoring








Building Your Revenue Stream... Survey Says

2012 PLANADVISER Experience Survey

Average annual charge for services to retirement plans, by plan size

	\$1MM	\$5MM	\$20MM	\$50MM
Less than 1 BP	3.6%	3.5%	3.1%	4.3%
1 to 5 BPS	2.1%	1.7%	2.4%	9.1%
6 to 10 BPS	0.3%	1.2%	10.6%	34.6%
11 to 25 BPS	9.9%	33.3%	67.8%	45.9%
26 to 50 BPS	35.8%	43.8%	11.6%	4.8%
51 to 75 BPS	24.5%	9.6%	3.1%	0.4%
76 to 100 BPS	16.4%	6.1%	1.4%	0.4%
More than 100 BPS	7.5%	0.9%	0.0%	0.4%

How advisers are paid for qualified plan business

	2011	2012	CHANGE
Commissions/12b-1s	62.4%	55.8%	-10.6% 
Fees based on assets	77.6%	73.3%	-5.6% 
Hard-dollar or flat fee*	47.1%	51.1%	8.4% 
Per participant	9.4%	9.9%	5.6% 
Per project	27.5%	24.8%	-9.7% 
ERISA budget/ERISA reimbursable	25.9%	30.7%	18.7% 
Other	1.2%	2.4%	97.0% 

* Regardless of asset size

Earning Your Target Billable Hourly Rate

Assume you work 50 hours per week and 50 weeks per year:

- \$100 an hour = \$250,000 per year
- \$250 an hour = \$625,000 per year
- \$300 an hour = \$750,000 per year
- \$400 an hour = \$1,000,000 per year

Analyzing Your Cost Structure

Costs

- Travel costs for an on-site visit with a geographically removed client
- Educational materials and support
- Staff time devoted to frequent calls, prep work, benchmarking and/or fund analysis
- Special licenses or certificates maintained to support a block of plans

Structuring Your Costs... Survey Says

2012 PLANADVISER Experience Survey

Plan services offered as part of retainer or annual service

	2011	2012	CHANGE
Attendance at investment/retirement plan committee meetings	97.5%	92.6%	-5.0% ↓
Ongoing investment monitoring	99.5%	89.6%	-10.0% ↓
Investment policy statement design	97.4%	88.5%	-9.1% ↓
Manager search/fund replacements	98.4%	88.3%	-10.3% ↓
Fiduciary and fund governance	96.6%	81.7%	-15.4% ↓
Provider fee analysis	93.0%	78.6%	-15.5% ↓
Enrollment meetings	93.5%	78.4%	-16.2% ↓
Benchmarking DC plan provider	89.6%	76.8%	-14.2% ↓
Written service contract/svc guarantee	96.2%	76.8%	-20.1% ↓
DC plan design	92.7%	76.3%	-17.7% ↓
Compliance reviews	94.0%	76.1%	-19.1% ↓
Employee group meetings, ongoing	93.9%	76.1%	-19.0% ↓

Vendor/fee review or benchmark study	84.9%	71.8%	-15.5% ↓
Communication policy stmt design	93.8%	69.5%	-25.9% ↓
Asset allocation models	87.5%	69.0%	-21.2% ↓
Employee meetings, one-on-one	88.5%	66.2%	-25.2% ↓
Vendor search/Request for proposal	72.8%	62.3%	-14.4% ↓
Individual participant inv advice	82.0%	48.6%	-40.7% ↓
Nonqualified plan design	58.9%	40.7%	-30.9% ↓
Defined benefit (DB) plan design	68.1%	37.7%	-44.7% ↓
Private wealth/HCE services	54.6%	25.2%	-53.9% ↓

Turning Around an Unprofitable Plan

Consider the What, How, Who and Why

What

is the current plan design structure?

How

am I determining the service model?

Who

is responsible for implementing these services?

Why

do I want to take on this plan?

What? Evaluating the Current Plan Design Structure

5 Plan Design Ideas to Turn Around an Unprofitable Plan

- 1) Less Restrictive Eligibility
- 2) Automatic Enrollment/ Escalation
- 2) Stretching the Employer Match
- 3) Safe Harbor 401(k)
- 4) New Comparability Profit Sharing Contribution

Did You Know?

*Opt-out rates for employees who are defaulted into their retirement plans are **less than 5%****

**Source – Profit Sharing Council of America, 2011*

Case Example: The Impact of Plan Design on Profitability

- XYZ Corporation has 200 employees with average compensation of \$50,000
- The matching contribution will be dollar for dollar (100%) on the first 3% of pay deferred into the plan
- The advisor receives 12b-1 fees based on total plan assets

Scenario 1

- Average deferrals at 5%
- Eligibility restrictions to years of service and age

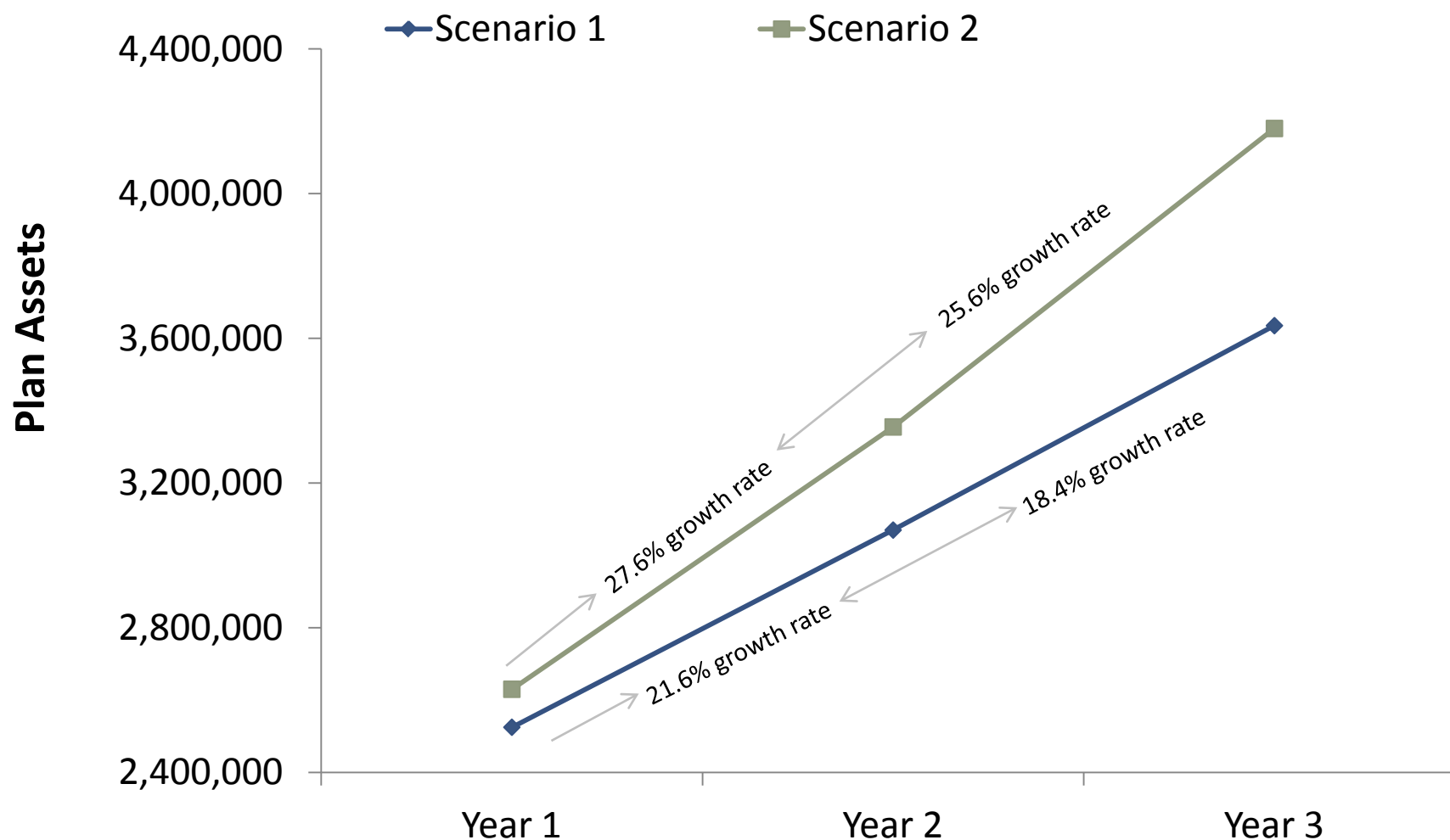
Scenario 2

- Auto enroll/ escalation starting at 6% in year one with 1% step ups for years 2 and 3
- Eligibility restrictions removed

- This is a hypothetical plan example meant for illustrative purposes only.

The Growth Rates are Good - But Can Be Better

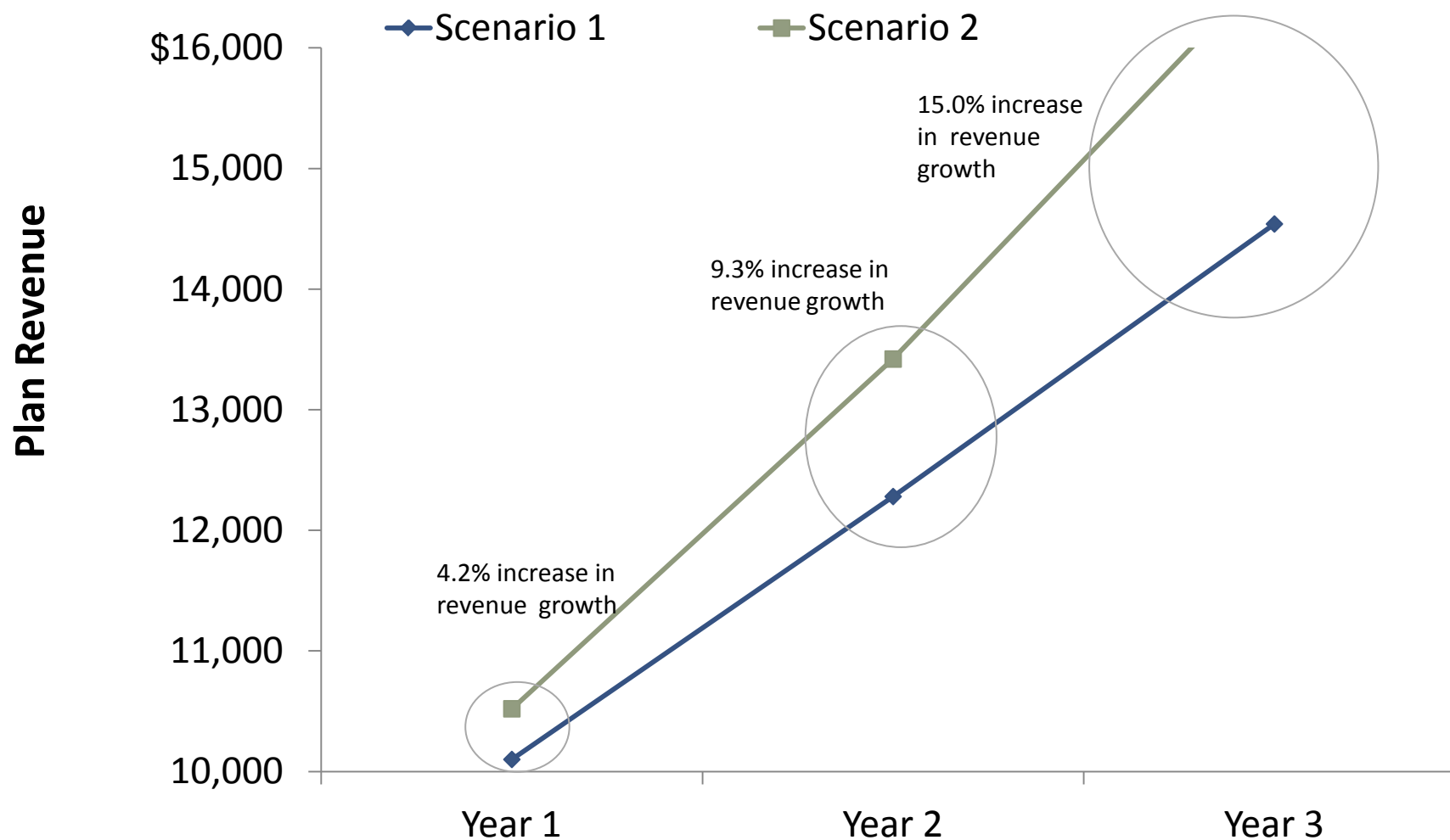
Plan Asset Growth Rates



- This is a hypothetical plan example meant for illustrative purposes only.

Maximizing the Revenue Growth Potential

Plan Revenue Growth Rates



- This is a hypothetical plan example meant for illustrative purposes only.

How? Determining the Service Model

Tips to Ensure an Effective Service Model

- **Why do they have a plan?**
 - Align your service model with the motivations of the employer for sponsoring a plan.
- **Are you leveraging your recordkeeper relationships?**
 - Have you considered moving the plan to a record keeper that you have scale with?
- **What's the frequency?**
 - How often have you committed to applying these services?
 - Alternatively, you may consider other mediums of communication for contact in between the in person visits

Did You Know?

*A recent survey showed that participants in plans with educational communications after enrollment were **6x more likely to increase their deferral rates***

Building an Effective Team

- Providing better client service and meeting the needs of plan sponsors and participants
- Increased productivity, creativity, efficiency and clearer work objectives
- Enhanced communication
- Motivated staff
- Higher levels of job satisfaction
- Less stress

Retirement Plan Advisor Practice Structure*

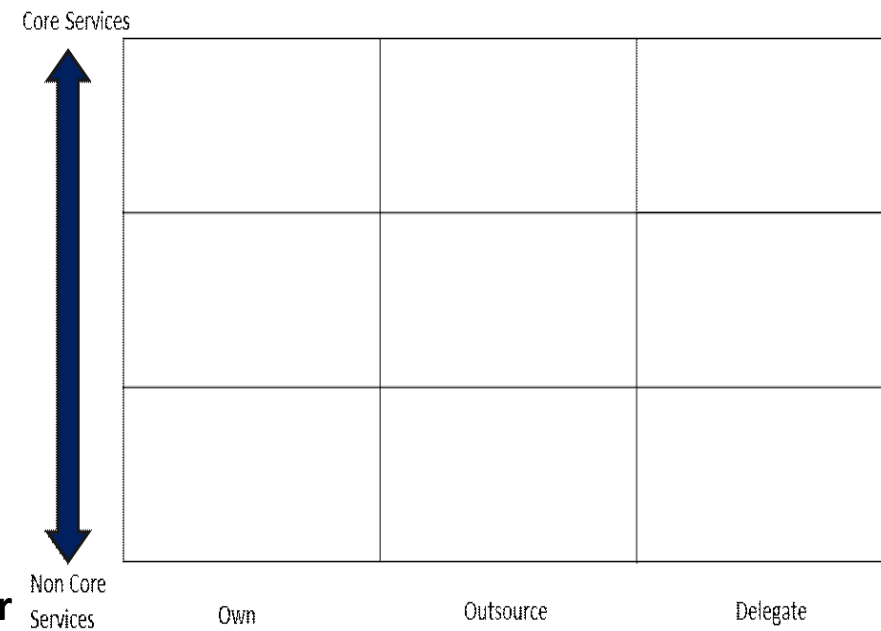


**2012 PLANADVISER Retirement Plan Adviser Experience Survey*

Who? Implementing the Service Model

Outsource, Delegate or Do It Yourself?

- **Review your service model**
 - This will determine the skill sets required of your team members
- **Identify the core and non-core services**
 - Identify the core services which will be personally handled by you
 - Assign remaining services to a functional role within your team
- **Consider the billable hourly rate of each team member**
- **Determine what, if anything, will need to be outsourced**
 - Assign someone internally to be responsible for managing the vendor relationship
- **Leverage the support of your service providers**
 - Many offer extensive tools, programs and articles that can be utilized with your clients



Guidelines for Adding Resources

- Reaching a certain threshold of retirement plan clients
- Reaching a certain threshold of retirement plan assets
- Enhancing your service model based on evolving plan client needs

Why? Considerations to Take on a Plan

Indirect Revenue Potential

- **Cross-sell other products** to the plan sponsor and/or net worth employees
- Value of the plan sponsor client as a **referral source or gateway** to other clients
- **Attain a client in a target market** in which you seek to develop a presence and expertise
- Learn from and use the client **as a success story** with other target clients

Did You Know?

*Nearly **one in four retirement plan advisors** said they get most of their new clients from referrals from existing clients*

**Source – PLANADVISER Experience Survey, 2012*

Using the Intel to Enhance Efficiency and Prospecting Efforts

- Use the findings of your plan evaluations to proactively target new prospects based on their attributes such as:
 - Firm's financial condition
 - Business type
 - Plan assets
 - Employee count
 - Expected financial return
- If there are plans you would not take on again, identify and document those attributes that make them unattractive
- Prioritize existing clients who don't meet your profitability criteria for the resources that they are consuming. If you cannot reevaluate their service or pricing model, you may need to forgo the relationship

Factoring in the Variables

- 1) Competition
- 2) Strength of demand
- 3) State of the economy
- 4) Market position (brand recognition)
- 5) Substitutes

Create an Ongoing Process to Review Your Plans' Profitability

4 Steps to Manage Profitability with Periodic Review and Adjustment

- 1) After completing plan evaluations, **review the metrics** that have the greatest impact on plan profitability within your practice
- 2) **Identify and document** those actions that were successful and contributed to profitability, and those that were not
- 3) **Consider the What, How, Who and Why** to turn around an unprofitable plan
- 4) **Share success metrics** with plan sponsors, such as an increased average account balance, increased plan participation rates, and more appropriate investment diversification across participant balances to illustrate your 'DC alpha'

Disclosures

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