

From left: Robert Stebbins, John Newman, Skip Schweiss, and Pete Kirtland.



PHILOSOPHICAL DIFFERENCES

Open architecture flexibility offers plan sponsors a potent tool in fulfilling fiduciary duties.

Plan sponsors have long appreciated the flexibility of an open architecture platform. That ability to mix and match the very best capabilities available has a new allure in a time when fee structure practices have drawn the scrutiny of regulators, legislators, and litigators. At the same time, technological advances are establishing a whole new generation of participant solutions. *PLANSPONSOR* recently sat down with several open architecture veterans—Pete Kirtland, President of 401k ASP; Robert Stebbins, Vice President of Pension Specialists; John Newman, Vice President of Fiserv ISS Institutional Retirement Plan Services; and Skip Schweiss, Executive Vice President of Fiserv ISS—to discuss the latest innovations.

PS: The strength of open architecture solutions has always been the unique flexibility in choice they provide plan sponsors and participants. Delivering on that promise obviously requires that the different entities involved work together as a cohesive team. What unique attributes do you look for in establishing those partnerships?

NEWMAN: Over the past year, we have added more than two billion dollars in new assets in this market space, working with third-party administrators (TPAs), recordkeepers, and advisers. We look for providers who have strong business models anchored by high integrity in their operations, compliance, and overall business processes. Strong business and process integrity is very important to us since we rely on our partners as being integral components of our overall trading and compliance processes.

KIRTLAND: To echo what John said, we look for ethics, honesty, and integrity, and we want business partners that are going to help us achieve what we consider to be the end game: allowing participants to retire with dignity.

STEBBINS: We agree with those sentiments. We are focused on the end user, that is, the participants that are being served by these plans and making sure that they can receive a fighting chance at reaching their retirement goals, and one way to do that is to line up a group of service providers who share that common mission.

KIRTLAND: One of the things that we find attractive about Fiserv ISS is that they are not just pure custodians sitting in an ivory tower balancing trust reports. They have a breadth of knowledge about the industry, and they have resources that they have readily committed to helping us grow our business; those types of partnership endeavors are very important to us.

SCHWEISS: We've been a trust company for 50 years now and our heritage is in acting as a direct trustee or custodian for retirement plans and various types of retirement accounts. In fact, 80% of our accounts here are retirement accounts. That's our niche and our specialty. We also believe that the firms we work with are very well positioned in terms of where the defined contribution industry is going: full disclosure on fees, revenue-sharing credits to plans.

NEWMAN: We contend that there always has been a very strong focus on fees but only on those fees that have been visible to plan sponsors and participants. Now, there is a greater understanding about the dramatic effect that mutual fund expenses have on investment results and, thus, retirement results over time. Also, now that members of the Baby Boomer generation are moving into retirement, they are seeing the effect that those expense ratios have on their account balances.

SCHWEISS: The Boomers, who are about to enter retirement, have



Open architecture gives more flexibility to sponsors and participants to seek greater rewards. It is especially appealing to those with high integrity who work well in closer partnerships.

FOCUS ON FEES

PS: Fees appear to be the hot topic these days: The Government Accountability Office has weighed in, the Department of Labor appears to be taking a hard look at those practices, the Form 5500 is getting ready to be an instrument of disclosure, and there were hearings recently on the Hill regarding the issue. Why is all this coming to the forefront now?

influenced so many things in this country, and now they are influencing the defined contribution market space. It's starting to come to light that we don't always have transparency around fees and, as a result, have fees that are really out of line with what they should be.

STEBBINS: I think a lot of the shift in focus on fees is driven by the shift from defined benefit to defined contribution plans. Plan sponsors cared about fees in defined benefit plans because they knew that, if they bought

a high-priced investment in the DB plan and it eroded plan returns, they would be required to make greater contributions to the plan. Defined contribution plan sponsors have had less direct financial incentive to stay on top of investment fees in a way they did in DB plans.

KIRTLAND: Some in the industry are concerned that, if you flush all this stuff out into the open and you start telling people how much they are going to pay, they are not going to participate in these programs, but I think that is selling the average person far too short. Quite frankly, in many cases, they should be shocked at how much their plan costs. I don't think it's going to drive people out of plans; I think it's going to advocate for lowered costs and that is ultimately a good thing. Our free market works great when you have information.

PS: Is the marketplace demanding change, or are we simply afraid of being sued?

KIRTLAND: Clearly, the lawsuits are having an impact. When you sit down with plan committees today, this is something they talk about, but 99.99% of the plans in this country are not being sued. I think what's driving this is a core group of participants who are beginning to understand that this is a really important part of the net balance that they are going to have at retirement and that, if their committee is not going to pay attention to this, they are going to advocate strongly that they do pay attention.

PS: How many participants do you think are aware of these fee issues, and their impact?

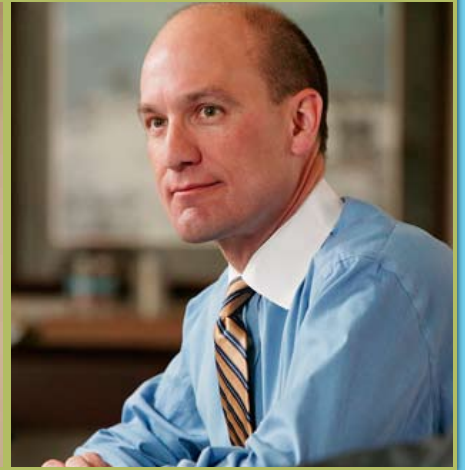
STEBBINS: Too few. I ask in virtually every participant meeting or presentation I'm in: "What fees are you paying in your retirement plan?" I can count on one hand the number of definitive answers that I have received to that question. So, if the participants aren't aware of the fees they are paying, it follows that they are unaware of their impact.

NEW STRUCTURES

PS: Transaction flexibility obviously plays a role in facilitating the effective interaction of the various parties. What new developments are emerging?

NEWMAN: Gone are the days where people need to be physically in their shops pushing buttons to send or retrieve data files shared among the parties. We are increasingly moving toward a straight-through processing environment where trading processes, distribution processes, contribution processes, and all the overnight processes are automated and thus require fewer staff to manage.

SCHWEISS: There has been a greater recognition among plan sponsors



that the majority of their participants do not have the knowledge, interest, or time to manage their own accounts effectively. So, many of the advisers that work with us use our platform to create managed portfolios or, in some cases, invest in our collective funds and manage under those portfolios.

NEWMAN: Typically, it's 60% to 70% of total plan assets that will go into those managed accounts on the plan level and, as a result, offering managed portfolios and collective investment funds to advisers has been the fastest growing part of our business here at Fiserv ISS.

KIRTLAND: Collective funds at least, generally speaking, deal with some of

the fee issues we've talked about with mutual funds. In an era when people are increasingly worried about fees and revenue-sharing, if you've got the right packaging, collective funds are a very acceptable alternative.

SCHWEISS: Another innovation is exchange-traded funds, or ETFs. They are inherently difficult to trade for most daily-valuation recordkeeping systems. The way that you effectively trade them is to move them into a managed portfolio or into a collective investment fund. So, those two

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– Robert Stebbins

trends come together where advisors can offer a managed solution and offer a lower-cost investment alternative.

PS: Is the problem how much we're paying, or is it knowing how much we're paying?

STEBBINS: There is a fiduciary mandate in ERISA that provides that, if you are spending other people's money—which is what fiduciaries are doing in a retirement plan—you need to know what you are spending and what value you are receiving in exchange. You're not mandated to choose the least expensive option; you certainly can make an argument for paying more when you receive additional services—for example, a plan sponsor that needs monthly communication meetings at a dozen locations across the country is a more expensive proposition than the plan sponsor that has one central location and wants annual meetings. So, there are going to be situations where plans pay more and should pay more, but plan sponsors need to know what they are paying and they need to be able to say with confidence, "I think we are getting a good value for those fees".

NEWMAN: Part of that process is just making sure you look at multiple vendors when taking the plan out to bid to compare what the differences are, to make sure you are getting the service and value that you want.

KIRTLAND: The problem is clearly disclosure. Sponsors and participants should know how much they are paying, just as they do with any other service or merchandise they purchase. If everyone were working with the

NEWMAN: We do offer access to more than 5,000 mutual funds on our platform for retirement accounts. In terms of fee reporting, we report all of our directed trustee and custodial fees to plan sponsors each quarter on an invoice. We also provide plan sponsors a quarterly statement that reports all of the revenue-sharing amounts, such as shareholder servicing fees that come from investment-related products, so it gives them the ability to see exactly what they are getting from the investment menu that they've chosen to invest in and then how those dollars are being divided among the providers to the plan. We're also negotiating with each of those 5,000 mutual funds to obtain for our partners the maximum number of basis points that are available.

PS: Aren't unbundled solutions inherently more "complicated" than the one-stop shop?

KIRTLAND: In our world, the client only needs to call one person. The inherent advantages of an unbundled solution are that you can hire best-of-breed service providers; the best accountant, the best investment advisor, the best recordkeeper, the best funds, the best custodian. If one component fails to perform, that piece can be replaced; you don't have to throw the baby out with the bath water.

SCHWEISS: We all work with multiple vendors in our personal lives. I might know a painter and a plumber and an electrician, but I don't have one person who does all of those things because each of the individuals

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same set of facts, they would be able to make an informed decision but that would be detrimental to those that overcharge, so I'd imagine they'll do what they can to impede the progress of full fee disclosure.

STEBBINS: I would echo that. In fact, disclosure at the large end of the market is improving. Large plans often receive reporting now that drills down to exactly what the plan is paying on an "all in" basis and breaks this down on a per-participant basis as well. You can get a sense, if you're a plan sponsor, of what the true cost of your plan is. It is much rarer to see this level of reporting in the small or mid-size plan marketplace.

NEWMAN: There was a study a few years ago that determined that about 70% of the fees being paid are investment management fees, 20% for recordkeeping, and the remaining 10% for trust and custody. If you really want to drill down to what's being paid, a bulk of the cost—two-thirds or more—is being paid in investment management fees.

STEBBINS: Why is there any debate on fee disclosure? If our industry feels that fees in retirement plans are fair, why aren't we just telling everyone what they are paying? If fees are fair and can be supported, then the industry should move to full disclosure immediately. Yet, there appears to be much debate on this matter.

THE POWER OF OPEN ARCHITECTURE

PS: What about the negotiating power of the open architecture structure?

specializes in a specific trade; they don't specialize in all of those things.

STEBBINS: We view ourselves as a bundled provider. The primary point of contact for our clients is a Pension Specialists account manager, who is charged with doing or coordinating the things that need to be done to serve that client. So, although there are different groups in the background providing certain services, the plan sponsor is never put in a position where it would have to cobble together the different service providers. The only difference from a more traditional bundled platform is that we don't bundle in a fund menu, and I would argue that this is a good thing.



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