Cover Story
Sustaining Income Through Retirement:
Four Strategies for Retiring Clients
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Together we’ll go far
3 President’s Message
Robert G. Wuelfing, SPARK

4 COVER STORY
Sustaining Income Through Retirement: Four Strategies for Retiring Clients
Noelle E. Fox and Drew A. Denning
The Principal Financial Group®

8 Communications
Overcoming Employee Inertia: How Interactive Video Can Help Increase Plan Participation
Gregory Newman, vWise, Inc.

10 Washington Update
Unfinished Business in Washington
Stephen M. Saxon, Ellen M. Goodwin
Groom Law Group

14 The SPARK Institute Review
Larry Goldbrum, The SPARK Institute

16 403(b) News
More Guidance and More Questions
Evan Giller, Giller & Calhoun

20 Member Profile
John P. Polito, Enterprise Iron Financial Industry Solutions

24 Consultant’s Corner
Winning Retirement Plan Service Business: RFP Tips from a Consultant’s Perspective
Jeffrey H. Snyder, Segal Advisors

28 SPARK Designations
Retirement Recordkeeping

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This issue of The SPARK Journal covers an array of topical issues from investment and communications strategies to legislative and regulatory updates. Our cover story, by Noelle Fox and Drew Denning of The Principal Financial Group, offers an informative discussion of a hot industry topic – retirement income strategies. We are also pleased to introduce a new regular feature in The Journal, the “Consultant’s Corner.” In this issue, Jeffrey Snyder of Segal Advisors offers tips for service providers on putting together a winning RFP. We will have similar insights from leading consultants in each future issue.

Other informative articles include a commentary by Gregory Newman of vWise on the use of interactive video communication to increase employee participation; an overview of current guidance regarding 403(b) plan regulations by Evan Giller of Giller & Calhoun; and a thorough review of recent activities in Washington by Steve Saxon and Ellen Goodwin of the Groom Law Group. Larry Goldbrum also highlights recent activities of The SPARK Institute, including our proposal for a universal, standardized 401(k) plan for small employers and a new white paper on a Statement of Financial Accounting Standards regarding the valuation of assets in retirement plans. Our member profile this quarter features John Polito, president and CEO of Enterprise Iron Financial Industry Solutions, a leading technology, business process and strategy development firm.

2009 SPARK Forum

The 2009 SPARK Forum, November 8-10 at the Breakers in Palm Beach, is almost upon us and I want to encourage SPARK members who have not already registered to attend the conference. Our website includes online registration capability to make it even easier to sign up. Go to: www.sparkusa.org/spark-forum.php for complete information about the Forum, including the agenda and registration links for both the conference and hotel.

The Forum provides educational and networking opportunities for executives, managers and other retirement plan industry professionals, including TPAs, financial advisers, RIAs, record keepers and fund company attendees. We have more than a dozen sessions covering the latest issues and trends in the retirement plan industry. Among our featured speakers are Jim McCarthy, Head of Client Advisory and Retirement Services at Morgan Stanley Smith Barney, who will discuss the role of wirehouses in the qualified plan market, and Dr. David Kelly, Chief Market Strategist at JPMorgan Funds, who will offer a long-term investment outlook and explore its implications for retirement savings.

Complementing these presentations is the Services Exhibition, which gives us all an opportunity to learn about the latest investment, communications, technology, record keeping and other products offered by our expanding array of exhibitors.

I look forward to seeing everyone at The Breakers next month.
Sustaining Income Through Retirement:
Four Strategies for Retiring Clients

By Noelle E. Fox
Retiree Services Group, the Principal Financial Group®

Drew A. Denning

Over the next 15 to 20 years, baby boomers are expected to reallocate nearly $8.4 trillion in retirement assets from investment products that support wealth accumulation to those that will support spending needs through retirement.\(^1\)

Fortunately, today’s retirees have access to a much wider range of strategies for turning personal savings into reliable streams of income than their predecessors had.

This article discusses and contrasts four strategies for turning retirement savings into a sustainable retirement income stream: mutual funds with automated income payments; variable annuities with guaranteed minimum withdrawal benefits; income annuities; and combinations of mutual funds and income annuities.

It has been well-reported throughout the media that baby boomers face an uncertain financial future as they transition from full-time employment into their retirement years. But fortunately for today’s retirees, there has never been a more diverse range of strategic alternatives available for turning personal savings into retirement income.

How Can Retirees Maintain Adequate Income?

During the wealth accumulation phase, saving – and then saving even more – is the best strategy an individual can follow to improve his or her chances of accumulating adequate retirement funds. Similarly, in the distribution phase of a retiree’s life, the rate at which money is spent is the most important factor in maintaining sufficient retirement income for the rest of his or her life.

While saving more and spending less are the key drivers in establishing and maintaining a secure retirement income,

\(^1\) Playing the Long Game: Global Asset Management 2006, Boston Consulting Group, December 2006
retirees may also improve their income flow by employing thoughtful asset allocation strategies and utilizing innovative retirement products throughout their retirement years.  

**Strategy 1: Mutual Funds with Automated Income Payments**

Mutual funds with automated income payments are designed to automatically provide a steady, inflation-adjusted monthly payment, much like some income annuities. But, where an income annuity turns a lump sum investment into a stream of payments, a mutual fund with automated income payments still offers access to the underlying account balance. Also, the income distributed by these mutual funds is not guaranteed to be either steady – predictable from year to year – or to keep pace with inflation.

Despite these risks, a retiree’s worst-case scenario – outliving his or her income – may not be as probable when mortality is factored into the estimation. As an investor ages, his or her chance of running out of retirement savings increases. And as the chance of running out of retirement savings increases, the chance of the investor being alive decreases.

Mutual funds with automated income payments come in two forms: endowment-style and self-liquidating. Each form works in a different way to help control the risk of an investor outliving his or her savings. While mutual funds with automated income payments do fulfill a retiree’s need to generate income, they lack the ability to provide full income for life and the income predictability of other retirement income strategies.

**Strategy 2: Variable Annuities with Guaranteed Minimum Withdrawal Benefits (GMWB)**

A variable annuity contract with a guaranteed minimum withdrawal benefit rider (GMWB) is a distribution choice for retirees concerned about maintaining a minimum retirement income. As a variable annuity, the product allows the owner to stay invested in the market, similar to Strategy 1. And the GMWB rider provides a minimum level of income through guaranteed benefit payments.

By opting to receive income payments at a fixed percentage rate for life, a retiree is protected against outliving this particular income stream. The guaranteed portion also establishes an income “floor,” which cushions the retiree against market risk. This means that, regardless of fluctuations in the value of the investment options that make up the variable annuity contract, the retiree will continue to receive a guaranteed minimum income payment for life.

It is important for owners to understand that the guaranteed income payments and fees associated with GMWBs are based on an amount called the “benefit withdrawal base,” not the actual account value.

If income payments are taken immediately after purchasing the GMWB, the benefit withdrawal base is equal to the actual or market account value. For example, if $500,000 is invested in the GMWB, the initial benefit withdrawal base will be $500,000. And while the benefit withdrawal base determines what the withdrawal fee amounts will be, those withdrawals and fees are deducted from the actual account balance.

Because this is a variable annuity product, the benefit withdrawal base has the ability to “step-up” in response to market gains in the account value. This step-up enables the owner to receive higher guaranteed income payments.

The primary benefit of the GMWB is its guaranteed income payment. This does not mean, however, that the owner’s actual account balance is guaranteed. The actual account balance can decrease due to poor market performance, which can lead to a lack of future step-ups in the benefit withdrawal base. Still, despite this risk, income payments will not decline below the guaranteed level.

While the guaranteed income may provide retirees with some assurance, it comes at a price – the GMWB fee. Fees associated with the GMWB are the price retirees pay for the assurance of knowing they will always receive a minimum income.

Although many GMWB owners will benefit from occasional step-ups and increased income payments soon after purchasing the product, the account balance will eventually decline.

**Strategy 3: Income Annuities**

Income annuities turn a lump sum of retirement savings into a regular stream of income. That income stream can be guaranteed for life, protecting a retiree against the risk of outliving his or her savings. Income annuities have no risk from market exposure and maximize spending for an individual.

With relatively low fees and fully guaranteed payments, income annuities are generally considered a cost-effective strategy. But, as with all retirement income products, there is a tradeoff.

Chief among the drawbacks owners encounter with income annuities is a loss of control. More recently, some income annuities have introduced options that allow a partial level of cash liquidity after the initial purchase. However, when exercising this liquidity option, future payments are reduced proportionately to reflect this return of purchase premium.

Other concerns can be addressed through the selection of additional features, but adding features will reduce the

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2 Diversification/asset allocation is no guarantee for future results.
3 In addition, some companies include what are called “sunset” provisions on the GMWB, which would terminate the option of step up when the retiree reaches a certain age or after a specified number of years.
4 Guarantees are based upon the promises and claims-paying ability of the issuing insurance company.
Four Strategies for Retiring Clients  
(Continued from page 5)

income payment received. Still, the cost may be worth it if those features address key owner concerns, such as: the risk of dying before the owner has received much value from the annuity; the risk of the owner's spouse not being covered after the owner's death; and inflation risk.

Although income annuities can create cost-effective, inflation-protected income that is guaranteed for life, they are not a complete solution to retirement income. Retirees need some liquidity to pay for the unexpected costs in retirement, especially those that arise in healthcare.

**Strategy 4: Combinations of Mutual Funds and Income Annuities**

The income annuity becomes a more effective solution when combined with other investment options, such as mutual funds. While the mutual fund provides market exposure, control, liquidity and flexibility in spending, the annuity provides a baseline of guaranteed income.

By combining traditional investments, a retiree can generate retirement income that adequately meets all of his or her retirement needs at a low cost. Adding a slice of income annuity to a portfolio may create a higher and more predictable income versus investing solely in mutual funds. In addition, over a long retirement the account balance may be higher since it is not supporting the full income stream. However, this solution is not for everyone. Consider the example of a retiree entering his or her drawdown phase with a significant portion of guaranteed income from a combination of pensions and Social Security. In such cases, retirees may be better equipped to face the unexpected costs in retirement by forgoing an annuity purchase and keeping their remaining savings liquid.

Also, income annuities are typically not appropriate for individuals in poor health, as longevity protection is not the primary concern.

**Conclusion**

The below chart summarizes the tradeoffs highlighted in this article. It is clear that no single product or withdrawal strategy is always the right answer for every retiree and every situation.

As the population of baby boomers enters retirement, financial guidance will be an imperative component of this generation’s success in shifting from wealth accumulators to wealth consumers.

This article is based on the research paper, Sustaining Income Through Retirement: Four Strategies for Retiring Clients.
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Overcoming Employee Inertia: How Interactive Video Can Help Increase Plan Participation

Gregory Newman
Chief Operating Officer
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Used wisely, a 401(k) plan can be an extremely effective retirement savings vehicle. Most eligible employees, however, are not making the most of their 401(k) plans, either because they contribute less than the maximum allowable amount, or they fail to participate at all. Up to 50% of eligible workers choose not to enroll in their employer’s 401(k) plans, and of those that do, less than 10% contribute the maximum amount allowed by the plan.

Research reveals that while employees cite a variety of reasons for their reluctance to participate, a common theme emerges: inertia. Even basic 401(k) plans can be confusing, and most employees have questions. Providers and sponsors produce materials designed to answer such questions, but many fail to adequately communicate. Without answers, employees lack confidence – or a sense of urgency – and thus decline to act.

An effective communications program can overcome employee inertia, helping companies maximize the potential of this important retirement savings vehicle and attract and retain key talent. There’s another reason for making effective communication a priority. Plan providers and sponsors are under scrutiny by regulatory and legislative bodies calling for increased education and disclosure to plan participants.

We recommend a 401(k) “engagement engine” that incorporates a regular schedule of outreach to drive eligible employees into a rich-media (i.e., video-based interactive) environment that engages them in a personalized investment plan development process, and facilitates the enrollment and updating process with the provider.

Barriers to Plan Participation
What keeps people from participating, or participating more fully, in their 401(k) plans? We have identified several reasons.

Lack of financial education. Eligible plan participants come from a variety of different backgrounds and have varying levels of financial sophistication, and tailoring a communications program to address these complexities is, at a minimum, challenging.

Lack of foresight. People tend to live in the present, and delay making important decisions about retirement – often until it’s too late. There’s plenty of information out there available to anyone who’s interested in learning about how to plan and prepare for retirement, but it is not being utilized.

People guard financial information. Research has found that people are reluctant to share their personal “balance sheets” and seek advice regarding retirement planning from investment professionals provided by their employer – more reluctant, in fact, than they are to share their health information.

401(k) plans are intimidating and confusing. Regardless of a participant’s sophistication, plan documents and the enrollment process often present a roadblock to participation and contribution in a 401(k) plan. These documents are complex and difficult to understand, and the enrollment process can feel overwhelming.

Creating A 401(k) Plan “Engagement Engine”
We reviewed the communication tactics commonly used by plan sponsors and providers to encourage eligible employees to participate and contribute to 401(k) plans. Some, such as live seminars and on-site meetings, can be quite effective at increasing participation, but are too costly to use as part of an ongoing campaign. Other tactics, such as newsletters and
text-based internet sites (even those with interactive tools), are often overlooked by participants who want answers in a format they can readily access.

An effective 401(k) plan communications solution overcomes employee inertia to become an “engagement engine” helping companies maximize the potential of this strategic retirement savings vehicle and attract and retain key talent. What are the key features of a 401(k) engagement engine?

**Video-Based Presentations.** The single biggest factor in the success of any learning program is the accessibility of the information being presented. And the largest impact on participation and contribution rates in 401(k) plans is found through the use of a video-based user environment. Employees can access material on their own time and at their own pace, in a format that is familiar and easy to understand. Video offers many of the benefits of a live presentation, without the expense; and professionally produced video can deliver a message just as powerfully – or more – through the use of supporting graphics and materials woven into the video.

**Interactive Applications.** A communications plan fails unless it has the ability to stimulate particular action in the audience. Namely, it must convince them to participate in, or increase contributions to, a 401(k). To perform this role, the plan must rely upon proven techniques from advertising, and the powerful interactive tools available within a rich internet application. An effective plan must include the ability to discern user needs and requirements through interactive survey forms, database technology and sophisticated user tracking mechanisms built into the system. For instance, a 401(k) “engagement engine” can be programmed to present contextual information, based on a plan or user profile.

**Timely Information.** Additionally, to perform adequately over time, the communications program must offer fresh and timely information, delivered via electronic methods, that helps participants evaluate their plan investments. News and updates relevant to participants – from general financial news to specific company announcements – should be published on a quarterly basis or more frequently, in a format such as email, that is easily accessed and contains links to the video-based environment.

**A Powerful Outreach System.** Outreach is an important part of what makes an engagement engine so effective. The ideal solution should include integrated email and video tools to deploy automated outreach campaigns that bring employees back to the interactive-video website.

**Analytics.** Measuring the results of your outreach efforts is critical to improving performance, which is why an engagement engine is not complete without ties to an analytics package. Standard web-based metrics, including number of visitors, time on site, pages viewed, etc., will show you how your engagement engine is being used, and by whom, so you can tailor future campaigns appropriately.

**A Proven Solution**

The engagement engine concept above was tested with a large plan sponsor. Harrah’s Entertainment deployed a non-integrated version of our solution in 2008 and, with minimal promotion of the system, generated new-employee plan participation rates comparable to live, on-site meetings – for a fraction of the cost.

So how do you overcome employee inertia? With a 401(k) engagement engine, proven to increase plan participation and to help fulfill fiduciary duty, while reducing the need for print communications and on-site meetings.
Unfinished Business in Washington

The Department of Labor has a lot on its plate this year – most of it in the form of unfinished but important regulatory projects left over from the Bush Administration. Many of these projects have to do with fees and expenses paid in connection with 401(k) plans. In 2008, the DOL proposed regulations under ERISA section 408(b)(2) having to do with service provider compensation. These regulations would require participant-level disclosures of plan fees, and regulations interpreting the Pension Protection Act’s investment advice provisions. None of the regulations became effective before President Obama placed them in “deep freeze” after his inauguration. That said, we expect some of these regulatory initiatives to see the light of day in final form, albeit a very different form than proposed.

The new Assistant Secretary of Labor for the Employee Benefits Security Administration, Phyllis Borzi, has announced that she intends to move forward with these regulatory initiatives, despite the fact that Congress is currently considering several 401(k) fee legislative proposals. A bill has also been introduced in Congress that would place very heavy restrictions on the provision of investment advice to 401(k) plan participants. Because Congress is heatedly engaged in the debate over health insurance reform right now, we think it is unlikely that any of these bills will be enacted this year.

In addition, President Obama has announced his own retirement initiatives, aimed at helping Americans find additional ways to save for retirement. A key component of President Obama’s retirement initiatives is the auto-enrollment IRA – a savings vehicle that would be offered by employers who offer no other retirement plan for their employees. We are concerned that the President’s focus on IRAs may be confused as an
endorsement of them as a sole retirement savings vehicles. While IRAs are a good supplement to retirement savings, we believe that IRAs are not the solution to America’s retirement savings problems. What American workers truly need are more incentives for employers to sponsor ERISA plans.

Below we summarize President Obama’s retirement initiatives, the DOL’s regulatory agenda, and the bills currently before Congress with respect to retirement.

**President Obama’s Retirement Initiatives**

The centerpiece of the Obama Administration’s legislative retirement initiatives is a proposal to create automatic IRAs. The Administration’s auto-IRA proposal would require all but the smallest employers to offer their employees automatic enrollment in an IRA if the employer offers no employer-sponsored retirement plan. Contributions to the IRA would be voluntary and employees could opt-out of contributing to the IRA. Nonetheless, they would be enrolled in an IRA established by the employer, and contributions would be deducted from their pay, if they took no affirmative action.

**Fee Disclosure**

The DOL’s Assistant Secretary Borzi inherited several items of “unfinished business” from the Bush Administration. With respect to fees and expenses, the DOL had proposed a regulation under section 408(b)(2) that would have required certain service providers to provide detailed information to their plan customers about direct and indirect compensation earned in connection with plan services and potential conflicts of interest. Although we understand that the DOL developed a final regulation last year, it was not published before President Obama took office, and was placed indefinitely on hold pending review by the Obama Administration.

The DOL’s participant disclosure regulation is also on hold. Specifically, last year the DOL issued a proposed regulation that would have required all participant-directed pension plans to provide detailed disclosures to plan participants about administrative, investment, and participant-level fees paid through plans as well as fees imposed by plan investment options. Ms. Borzi has announced that she intends to move forward with both of these regulatory initiatives, despite the fact that lawmakers on the Hill are currently considering pending legislation (described below) addressing these issues, and issue both final regulations early in 2010.

**Investment Advice for Participants**

Perhaps the most controversial unfinished regulatory project inherited by Ms. Borzi is the DOL’s investment advice regulation issued under the Pension Protection Act investment advice provision. The Assistant Secretary recently stated that the DOL’s final “advice” regulation, published on January 21, 2009, received substantial criticism for “going too far.” She explained that the PPA investment advice provision was carefully crafted to mitigate conflicts of interest in the provision of investment advice, and that her staff has been working very hard to make it consistent with the PPA’s prohibitions against conflicted investment advice. She indicated that the Department would be withdrawing the final regulation in its entirety and repurposing a new rule with a relatively short comment period.

**Legislative Update**

There are currently three 401(k) fee bills in Congress that would require service providers to provide disclosures to plan sponsors about fees charged in connection with services. In addition, each of the bills would require detailed fee disclosures to be provided by plans to participants.

The bill that has received perhaps the most media attention is the bill introduced by Chairman George Miller of the House Education and Labor Committee.

Continued on page 12
Although introduced as a stand-alone bill earlier this year, Miller’s bill has now been combined with a separate piece of legislation originally introduced by Robert Andrews that would place strict conditions on the provision of investment advice to plans and participants. The combined bill, jointly sponsored by Congressmen Miller and Andrews, is called the “401(k) Fair Disclosure and Pension Security Act of 2009” (H.R. 2989). This bill was reported by the House Education and Labor Committee this summer. The other 401(k) fee disclosure bills in Congress include the “Defined Contribution Fee Disclosure Act of 2009” (S.401) and “The Defined Contribution Plan Fee Transparency Act of 2009” (H.R. 2779).

The Miller/Andrews bill would expand the disclosures that plan administrators of 401(k) and other individual account plans must receive before entering into contracts with service providers. The bill would require providers to give a breakout of charges for the following services:

- plan administration,
- transaction-based charges,
- investment management, and
- other costs.

The bill would also require disclosures to 401(k) plan participants, including a fee comparison chart and detailed quarterly statements.

Importantly, the bill provides that a plan sponsor may obtain relief from fiduciary liability for participant-directed investment choices under ERISA section 404(c), only if the plan includes at least one investment option that is a “passively managed investment which is a portfolio of securities that is designed to be representative of the United States investable equity market or the United States investment grade bond market… or a combination thereof.”

The investment advice provisions of the bill would repeal the investment advice rules added by the Pension Protection Act of 2006, and impose substantial new restrictions on the provision of investment advice to participants and 401(k) plans. Most onerous is a requirement that advice be provided by an “independent investment adviser” who meets a detailed set of conditions. As the bill stands currently, all programs for the provision of investment advice to either participants or 401(k) plans, including programs that currently meet the DOL’s Frost or SunAmerica advisory opinions, would be adversely affected.

Because of the length of the Congressional debate over healthcare reform, we do not think there is time left on the legislative calendar to move H.R. 2989 to enactment this year. However, in a clever move, provisions dealing with defined benefit funding were added to H.R. 2989. We think that if any pension legislation moves this year, it will be pension funding relief. Combining the pension funding relief with the Fee/Advice proposals could create an opportunity for all of these proposals to be enacted.
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Proposed Universal Small Business 401(k)

The SPARK Institute recently recommended the creation of a simplified, universal employer-sponsored 401(k) plan for small employers as a vehicle to deal directly with the roadblocks small employers have identified as the reasons for not voluntarily adopting a 401(k) plan. In testimony that the Institute submitted to the Department of Labor’s ERISA Advisory Council in September, we proposed a standardized plan concept that includes the following ten features and requirements:

1. Be offered by any small employer (i.e., less than 100 employees), in business for at least one year, with at least one non-owner employee.
2. Include mandatory enrollment and contribution escalation features with participant opt out.
3. Impose the same contribution limits as for regular 401(k) plans.
4. Be governed by a single government-approved prototype plan document. The use of a model plan by all vendors and employers would substantially reduce administrative costs and would relieve employers of the enormous and costly burden of ensuring that their plan documents comply with applicable legal requirements.
5. Have limited plan features to prevent pre-retirement leakage (i.e., no loans or hardship withdrawals).
6. Have no discrimination testing. The elimination of discrimination testing will substantially reduce the compliance administrative burdens. The requirements that all employers offer a plan and that such plans include mandatory enrollment offset the need for such testing by providing access to a plan for all employees and requiring employees to affirmatively opt out if they choose not to save. Moreover, historical data shows that the vast majority of automatically enrolled employees stay in the plan.
7. Have no employer contribution requirements.
8. Include investment options that meet specified minimum requirements for broad-based investment choices. Investment options can be chosen by either the employer, if it prefers to do so and the service provider’s arrangement allows, or determined by the service provider as part of its product package. Employers and service providers would be protected from potential liability for investment losses for investments that satisfy safe-harbor criteria.
9. Allow the employer to choose the vendor and program to offer, but because all such programs would be subject to the same or similar administrative provisions and features, an employer would be in a position to readily compare plan and investment costs from vendor to vendor.
10. Permit vendors to aggregate assets across plans and employers, provided that individual plan and participant assets can be separately identified and accounted for in order to help reduce administrative costs and leverage potential investment option economies of scale among many participating small employers.

We believe that this type of arrangement can provide a cost-effective way for more employees to save through workplace savings plans and to leverage the current 401(k) system infrastructure and experience.

The SPARK Institute testimony also recommended that existing employer-sponsored plans be improved to help working Americans save earlier, save more and avoid taking distributions of the money they have in their accounts before retirement. The testimony noted, for example,
that mandatory automatic enrollment of employees and automatic escalation of employee contributions should be used as methods to increase participation in workplace savings plans and the rate of savings. Additionally, it urged legislators and regulators to adopt new laws and regulations that limit participants’ ability to cash out their retirement savings when they change jobs, while maintaining portability attributes. The complete testimony is available on The SPARK Institute website at www.sparkinstitute.org/comments-and-materials.php.

White Paper on Valuing Plan Investments Under FAS 157

In August, The SPARK Institute released a new white paper about the confusion among plan sponsors, record keepers, investment providers and auditors regarding roles and responsibilities in connection with the new Statement of Financial Accounting Standards 157 (“FAS 157”). While a lot has been written about the legal and technical aspects of FAS 157, practical problems continue to plague everyone involved in the process of a retirement plan audit, including plan sponsors, record keepers, investment providers and auditors. The majority of the problems stem from the complexity of the issues and uncertainty about exactly how the rules apply to retirement plan investments.

Roles and Responsibilities

The plan sponsor as the issuer of the plan’s financial statements is responsible for attesting that the plan assets have been reported at fair value and for classifying the plan investments under FAS 157. In order to satisfy those responsibilities, the sponsor is also responsible for determining what information is needed to classify the plan investments and obtaining the necessary information.

Record keepers, on the other hand, should provide information to plan sponsors that is reasonably available regarding the valuation of the investment products that it generally makes available to its retirement plan customers. However, unless the record keeper is also the investment provider, the record keeper is generally dependent on the investment provider to provide it with the information. Record keepers should have a good working knowledge of the information that plan sponsors will reasonably need in order for them to be able to categorize the investments under FAS 157. Some record keepers may also provide plan sponsors with a suggestion regarding the classification of certain investment products that it makes available to its plan customers. However, the suggestions will generally include significant legal disclaimers that inform the plan sponsor that they are not intended as legal or accounting advice to the plan sponsor, valuations are not independently verified by the record keeper, and do not relieve the plan sponsor from its ultimate responsibility to make the determination.

Need for Guidance in Classifying Certain Assets

Among the challenges presented by FAS 157 is that it is not entirely clear regarding how to classify certain assets. Among the hard to value assets are plan specific separate accounts, collective investment products, managed accounts, plan loans, insurance company general accounts, insurance company separate accounts that invest in mutual funds, and thinly traded stocks. Unfortunately, plan sponsors, record keepers, investment providers, auditors, lawyers and other experts find themselves in the same difficult position with respect to these assets. The proper valuation and classification of these assets cannot be determined with reasonable certainty absent further guidance from FASB. Without that guidance plan sponsors must make a good faith attempt to comply with the rule. ■
When the Internal Revenue Service issued new regulations under IRC section 403(b) in July, 2007, it was the first complete revision of those regulations since 1964. Almost simultaneously, the Department of Labor changed the filing requirements applicable to 403(b) plans under Form 5500, significantly increasing the information that must be provided effective for 2009 plan years. After years of quietly keeping a low profile, 403(b) plan sponsors and investment providers have suddenly found themselves to be in the center of attention. Their efforts to comply with the new rules have generated a vast array of questions and issues, and much discussion. The two agencies have responded to many of these questions with a steady stream of formal and informal guidance, which then tend to raise yet additional questions. Each agency recently released their latest installments of this continuing story.

**IRS Announcement 2009-34**

One of the changes implemented by the new 403(b) regulations is the requirement that all 403(b) arrangements be maintained in accordance with a written plan. This requirement set off a whirlwind of activity in the plan drafting community. But because the plan document requirement was a new one under 403(b), some of the tools that 401(a) qualified plan sponsors use to meet the need for a plan document, including prototype plans and determination letters, were not available to 403(b) plan sponsors.
On April 14, 2009, the IRS issued Announcement 2009-34, setting forth its intention to establish a prototype plan program for 403(b) plans and, later, a determination letter program. The program, described in a draft Revenue Procedure, will be similar to the program that currently applies to qualified plans. The prototype plan program will allow a prototype plan sponsor to get an opinion letter from the IRS that the form of its plan complies with the requirements of 403(b). Eligible employers that adopt an approved “standardized” prototype plan will be able to rely directly on the opinion letter received for that plan document. A prototype plan is “standardized” if it provides for elective deferral contributions only or it automatically meets all non-discrimination requirements with respect to other contributions. If the employer adopts a “non-standardized” plan, it may rely on the plan’s opinion letter, except for the issue of whether the plan satisfies the non-discrimination requirements. The IRS also issued some draft sample plan language, and invited comments on the language and on the draft Revenue Procedure.

The IRS stated that it intended that the prototype program would be available to be used by “most eligible employers.” However, there are some aspects of the proposal that may greatly limit the appeal of the program and have raised concerns and questions among potential users. These include:

- The program does not allow for delayed vesting, as the IRS did not believe that this was a common provision in 403(b) plans. In fact, as was noted in a number of comments, a significant percentage of 403(b) plans do contain a delayed vesting provision.
- The program and the model language provide for very limited flexibility in plan design, including in such areas as permissible contribution schedules, waiting periods, and excludible categories of employees. This could prevent the program’s use by plans which have more complex designs.
- The program requires that the plan supersede any conflicting provision in a funding vehicle. Because of the complex nature of the funding vehicles used in 403(b) plans and the difficulty or impossibility of changing their terms, this rule could result in inadvertent operational failures.

The IRS has publicly stated that, as of early September, there were about 20 comment letters submitted, many of which expressed concerns about the above provisions as well as others. An IRS official has said that the Service is receptive to the suggestions made and will go back and take another look at the program as a result of the comments. It appears likely, for example, that delayed vesting will be permitted as part of a 403(b) prototype plan. The IRS is also likely to address the concern about conflict between the funding vehicles and the plan.

**DOL Field Assistance Bulletin 2009-2**

A major element of the change in the Form 5500 filing rules for 403(b) plans is the requirement that “large” ERISA covered plans (generally those with 100 or more participants) file audited financial statements beginning in 2009. Prior to this change, 403(b) plans were not required to maintain the financial records that now need to be audited. For example, before the final IRS regulations, some employers allowed participants to transfer accumulations to funding vehicles not selected under the plan without the knowledge or involvement of the plan sponsor. Consequently, it will be difficult, if not impossible, for many 403(b) plan sponsors to identify all of the contracts that would need to be included in the audit and to determine the plan assets as of January 1, 2009. Plan sponsors were facing the unhappy prospect that their auditors would issue qualified or adverse opinions because they would be unable to certify that the plan assets were being reported correctly.

Continued on page 18
More Guidance and More Questions *(Continued from page 17)*

In DOL Field Assistance Bulletin (“FAB”) 2009-02, issued on July 20, 2009, the DOL acknowledged this problem and issued transitional relief. The FAB provides that certain contracts do not need to be included in the plan for purposes of the Form 5500 reporting requirements. A plan need not include a contract as part of the plan if the plan administrator makes a good faith effort to transition to the new reporting requirements, and:

1. the contract or account was issued to a current or former employee before January 1, 2009;
2. the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009;
3. all of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer; and
4. the individual owner of the contract is fully vested in the contract or account.

The DOL also said that in counting the number of participants in a plan (which may be important for determining if the plan is “large”), employees who only hold contracts that can be excluded under the FAB do not need to be included in the count. And the DOL will not reject a Form 5500 with a qualified or adverse opinion if the auditor states that its reason for qualifying the opinion is based solely on the exclusion of the contracts described in the FAB.

The FAB is extremely helpful in resolving some of the issues faced by sponsors, but, of course, it has led to some new questions, including:

- What constitutes “involvement of the employer” for purposes of meeting the third requirement for contracts to be excluded from the plan? While it appears that this will be a facts and circumstances determination, the DOL has recently clarified that a contract will not fail to come under the FAB unless the employer is exercising discretion over it.

In addition, the American Institute of Certified Public Accountants has commented that while the FAB explains DOL’s enforcement position, auditors still need to follow the applicable auditing standards. It appears that auditors may be looking for plan administrators to demonstrate that they have made a “good faith” attempt to find the information needed for an audit, even for contracts that the FAB otherwise permits the administrator to disregard. It is unclear what constitutes a “good faith effort” under the FAB.

These two releases reflect the healthy discussion that has been taking place between practitioners and regulators in an effort to accomplish a difficult task: the transformation of 403(b) plans. These discussions need to continue, and more guidance will be necessary before that goal can be achieved.

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**The American Institute of Certified Public Accountants has commented that while the FAB explains DOL’s enforcement position, auditors still need to follow the applicable auditing standards.**
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John Polito’s passion for technology started in a high school computer programming class. The school – Essex Catholic in Newark, NJ – is no longer there, but John’s love of technology has never wavered. He’s built his career and his company around the ever-evolving world of technology-based business solutions. John believes the key to a successful technology strategy is having a deep understanding of the business being supported. As a result, he’s made sure he and the people who work for him know the financial services business inside out. “Companies don’t always realize that technology is just part of the equation,” John says. “You really need to start by defining your business strategy, developing your end-to-end plan and truly understanding your products and services. That’s the important other half of the equation in gaining a competitive edge.”

**Career Moves**

John’s first full-time job came after he graduated from Essex Catholic in 1975. He worked with the check processing control systems department at Midlantic National Bank. Within six months, he was promoted to computer operator, handling the bank’s nightly processing work.

He worked nights because he also was attending Rutgers University full-time during the day. Even though he admits to finding college a little tedious, he stayed with it and graduated with a bachelor’s degree in computer science.

John also had married at 21, so when a job came along at Fidelity Union Bancorp that was closer to home, he took it. He was becoming well-versed in the DOS to MVS conversion process, as both Midlantic National Bank and Fidelity Union had gone through them. He was with Fidelity Union for three years, working on their Certificate of Deposit and DDA systems.

In 1983, John moved to First Jersey National Bank’s Securities Division as a senior programmer analyst. Again, he led the company’s conversion from DOS to the newer MVS operating system. Once the conversion was completed, he was responsible for new business conversions including Nations Bank, Merrill Lynch CMA, Prudential Bache and Evergreen, to name a few. John also was responsible for the firm’s active asset and money market transfer agency systems.

Later he headed a special team responsible for making required regulatory changes and selecting new financial products and implementing the technologies to support these new businesses such as ESOP, stock transfer, personal and employee benefits trust, and retirement services. So, when First Jersey entered the retirement business, John did as well, implementing SunGard’s Dyatron, which became OmniPlan and eventually OmniPlus.

A few years later, First Jersey was acquired by NatWest, which soon sold its transfer agency business to Sears, Dean Witter’s parent company. Sears assimilated all of First Jersey’s Securities Division employees and technology,
which kept John busy converting the business from the IT standpoint, including later when Sears spun off Dean Witter.

All told, John worked for Dean Witter and Morgan Stanley after their mergers for 17 years. When he left in 2000, he was a First Vice President with responsibility for personal and employee benefits trust, and retirement technology. Staying competitive over the years had meant ongoing software and technology upgrades, which weren’t hard to justify in the prevailing business climate. Just as important to John’s way of thinking was that besides hardware and software expertise, senior IT staff had to have a solid understanding of the business and were required to obtain a number of industry licenses.

“It wasn’t enough just to be as good as, or better than, the competition in terms of the technology,” he says. “The senior staff also had to know the related businesses they supported so they could better communicate with business users.”

A good example of how this philosophy paid off occurred during a bull market high in 1999. Brokers were focusing on selling securities rather than the less lucrative trust business. “While we were custodians of billions in trust assets, we often weren’t the trustee or the standby trustee. What the broker didn’t realize was that if the owner passed away, he could possibly lose the assets in the account to a competitor,” John explains. “But, by understanding both the technology and the business, our IT staff was able to identify the exposed accounts and build an on-line application that showed branch managers and brokers their exposure to this vulnerability. This got everyone’s attention, and brokers quickly learned about standby trustees and the problem was resolved. People came to realize that if IT was properly educated in their respective business and managed effectively, it could have a significant impact on the bottom line.”

John left Morgan Stanley in 2000, with the idea that he’d like to be in business for himself. He joined an IT staffing services company, Paragon, which wanted to move into the financial services business solutions area. As managing director with profit and loss responsibility, John established a successful financial industry solutions practice, building his team based on the idea practiced at Morgan Stanley – that staff was required to know the financial services business.

“We started focusing on association business and participated in a number of conferences and led roundtable discussions, specializing in such things as how to implement straight-through processing and Patriot Act mandates” he says. “We sold fixed-cost project work and had good success. Our larger clients included Mellon, ADP, Prudential, NASDAQ and Merrill Lynch, for whom we built their ultra high net worth technology platform for their international private client group.”

By 2002, John was ready to start his own business and asked John Crocker, with whom he’d worked at Merrill, to join him. They began writing their business plan in May 2002, and in January 2003 started Enterprise Iron full-time, with a goal of being a leader in delivering business and system solutions to the financial and retirement industries.

**Enterprise Iron**

People often ask John the origin of his company’s name. To anyone at all computer savvy, it’s easy. “Big Iron” refers to the mainframes used by large companies, and “enterprise” in the computer world means an organization that uses technology. “I come from a
mainframe background. So for me, it means ‘Big Blue,’” John explains.

The company has prospered despite the economic downturn and now employs about 250 people. The reason for its success, John believes, is a commitment to understanding the changing industry and regulatory mandates, as well as the latest technology required to meet them in a cost effective and efficient manner.

“Our approach is different from typical IT providers that do purely systems work. Because we also bring deep and significant knowledge of financial services, we can add more value, such as helping determine the best way to accomplish business objectives and achieve cost efficiencies,” he says.

A recent three-year project with a major investment firm is a good example. The company not only wanted to bring its extensive technology operation in-house, but also expand into foreign securities markets and enter the securities lending business. Enterprise Iron helped at every step of the process, from strategy development to product selection and negotiating the contract with the software vendor. “Now they have a global presence and are in the securities lending business. We do well in situations like this where we’re involved end to end,” John says. “On the other hand, if a company needs us to perform a SAS 70 audit, a conversion, or manage compliance regulation requirements, we can handle that too.

“Ensuring that a firm’s policies are in compliance and their products and services are soundly designed and accurate is important because it could affect the performance of someone’s account. It’s especially challenging these days when many people are from outside the financial services industry and many organizations are so large that regulatory information doesn’t always trickle down to operational and technology staff,” he observes. “I often encourage these firms to send enough of a variety of staff to industry conferences so that the individuals who need to implement changes will be up to speed.”

John spends most of his time these days meeting with clients to discuss business solutions and building the teams to do the work. However, he admits, “Sometimes I’d still like to be doing the work myself.”

He holds or has held his Series 7, 63 and 65, as well as certifications with Cannon Financial Institute, the Institute of Certified Bankers and the Project Management Institute. He also serves on the board of directors of several for profit and non-profit corporations.

On the Personal Side

Born and raised in New Jersey, John was active in a range of activities in
high school, from football to fencing, archery, boxing, woodworking and Boy Scouts.

Today, he lives in Colts Neck, NJ, and has three children: Michael, a graduate of Franklin & Marshall, heads up recruiting at Enterprise Iron; Brianne is a senior at the University of Pennsylvania where she is studying international medicine and is a cheerleading captain; and Taylor is in the eighth grade and plays guitar, lacrosse and likes show jumping.

John's work schedule keeps him busy, but when he has time he likes to fish and hunt. "But," he laughs, "I don't think I've done that in a couple of years."
The most critical step in putting together a successful proposal begins even before service providers respond to the first question in a request for proposal (RFP). That step is gaining a clear understanding not only of the plan sponsor’s explicitly stated needs, but also of its broader requirements and concerns. In addition, service providers are sometimes surprised to learn that proposals are frequently rejected due to their inadvertent oversights of very basic proposal requirements.

Service providers may take comfort from the knowledge that RFP development and the process of evaluating proposals is not a mysterious “black box” affair, but a straightforward service that consultants provide for their plan sponsor clients. This article describes how service providers can maximize their prospects for winning profitable new relationships.

Roles and Responsibilities
To begin, it is important to review the roles and responsibilities of all the players in the process: the plan sponsor, the consultant and the service provider.

The most important player, of course, is the plan sponsor (or the plan itself). Sponsors will provide basic facts about themselves in the RFP documents, but not necessarily enough to give service providers all the insights they need to create a winning proposal.

Since plan sponsors do not change vendors on a regular basis, most recognize the limits of their expertise in the complex task of vendor selection, and select a consultant for that purpose. Sponsors also understand the critical importance of picking the right service provider, given that...
these relationships typically last many years. The consultant’s principal function is to be the plan sponsor’s general advocate in vendor selection. Specific tasks in achieving those ends include:

- helping sponsors to identify their key goals in selecting a vendor;
- supporting the development of the RFP and ensuring that an ample number of qualified candidates respond;
- providing expert and objective analysis of RFP responses;
- assisting sponsors in making final vendor selections;
- negotiating contracts, guarantees, fund offerings (if applicable) and fees; and
- coordinating the implementation process once the contract is signed.

The service provider’s ultimate role is to become an extension of the plan sponsor. This requires providing top-notch administrative services, coupled with innovative technology, supported by experienced service personnel, including a strong array of investment offerings (if applicable) and well-designed education and communication resources – all at a competitive price.

It is the function of the RFP process to help sponsors determine whether any given service provider is likely to fulfill the requirements of that role. Questions posed in a standard RFP are listed in the accompanying sidebar (see “Elements of a Typical RFP”), but some RFPs also seek answers to unique questions that stem from problems the sponsor may have experienced with their current vendor. For example, an RFP might concentrate on how a service provider deals with plan audits or administers plan loans, or it may focus on required minimum distributions or another administrative process.

**Becoming Number One**

How can service providers maximize their prospects for being selected through the RFP process? The basic requirements are straightforward enough:

- Competitive fees. Plan sponsors are perhaps more sensitive than ever to the need to keep plan costs to a minimum as they seek all means to recover from investment losses sustained during 2008, as well as to meet the requirements of the forthcoming fee disclosure regulations.
- Flexible investment offerings. Even large money management organizations with many high-performing fund options may increase their prospects for winning new business with open architecture arrangements. For example, defined contribution plan sponsors may want to maintain existing relationships with one or more money managers handling other investment needs.

Continued on page 26

**Elements of a Typical RFP**

RFPs are intended to be thorough enough to enable plan sponsors and their consultants to make an accurate assessment of a service provider’s capabilities and prices, without imposing such heavy data-gathering burdens on vendors as to discourage them from submitting proposals. The following are the principal elements of a standard RFP for a bundled solution for a defined contribution plan sponsor, including investment management, record keeping and administration, communication/education services, participant on-site services and custodial trustee services.

- RFPs generally begin with sufficient background information on the plan to enable bidders to know how to assess the opportunity. That includes the history of the plan, along with key plan participant demographics and financial information. Introductions also describe the vendor selection process, including any special format requirements, relevant deadlines and the timetable for awarding the contract.
- The questionnaire portion of the RFP may be divided into sections in which service providers describe their own structure and history, and respond to detailed questions regarding their capabilities in various areas. These include basic plan record keeping, loan administration, regulatory compliance, reporting systems, participant communications tools (including voice response, web sites and call centers), plan implementation and set-up, systems capabilities and hardware and custodial trustee services. Service providers should also highlight new products and services, such as soliciting insurance carriers on annuity options, discretionary managed accounts, financial advice and investments designed for income preservation. Standard RFP questions concerning investments and investment performance include both qualitative descriptions of investment management philosophy and numeric performance data.
- Naturally, RFP questionnaires delve deeply into the topic of fees for all categories of services, including any fee-offset arrangements with other vendors that would provide services to the plan through alliance relationships. In addition, RFPs often seek to assess the factors a service provider would weigh in determining whether to raise fees in the future.
Relevant experience. Service providers cannot create experience they do not have, but it is natural for plan sponsors to have a higher comfort level with vendors that are already servicing plans like their own. Service providers should accentuate any similarities among their current clients and the sponsor they are seeking to win over.

Succinct, clear responses. Less may be more. Proposals with excessive boilerplate text or rambling statements can reasonably be interpreted, at best, as evidence of a lack of written communication skills and, at worst, absence of respect for the plan sponsor or consultant’s time. It may even be perceived as an effort to evade questions. Other oversights to avoid are presented in the accompanying sidebar (see “Pitfalls to Avoid in RFP Responses”).

A seasoned service team. Plan sponsors are not looking to provide on-the-job training for service providers’ team members and managers. The service team must include experienced professionals with technical expertise in operations, plan compliance, communication and education and implementation/ conversion. Also essential is an experienced relationship manager who can quarterback the service team and be responsive to the sponsor’s needs.

Overall commitment to the business. While this requires subjective assessment, sponsors and consultants look for evidence of this commitment in service providers’ track records. Have they introduced innovative services, products and technology? Do they offer service guarantees, alternative pricing options and service benchmarking practices and capabilities (both on a plan level and compared with similar sized plans or plans within a given industry/sector)?

Doing the Homework

While service providers cannot change the basic facts that define their capabilities and resources, they can – and should – put their best foot forward in their RFP responses. Service providers must do their homework on the plan sponsor before beginning to draft their proposals. That can easily be accomplished by carefully examining the sponsor’s web site and conducting a general web search for news about the sponsor. At a minimum, proposals that reflect a service provider’s knowledge of a plan’s history and any special features beyond those that are described in the RFP indicate the service provider’s level of commitment to understand and meet the sponsor’s needs.

Pitfalls to Avoid in RFP Responses

Sometimes, the most basic oversights can undermine a service provider’s attempts to win new clients through the RFP process. The following pitfalls have knocked even the largest and most respected service providers out of the running:

- Failing to answer a question. While most RFPs contain a multitude of questions, it can be fatal to assume that one or two can be skipped without being noticed.
- Forgetting who’s the boss. Service providers should never, for example, consciously decline to offer a particular requested investment option out of a belief that it would be inappropriate for the plan sponsor.
- Providing incomplete responses. For example, if an RFP requests at least a five-year investment track record for all funds, but one or more of the proprietary funds that the service provider wants to include in the proposal has not been in existence that long, the service provider should be prepared to offer outside funds with the requisite track record.
- Overlooking basic RFP parameters (i.e., minimum qualifications). Many RFPs include a list of minimum qualifications that were developed by the consultant and the plan sponsor to identify capable service providers. Because proposals from providers that do not meet these minimum qualifications are generally considered “non-responsive,” providers who do not meet one or more of the minimum qualifications should reconsider submitting a proposal.

A service provider might learn, for example, about a plan sponsor’s pattern of merger activity that may have implications for future demands. Thus, if the service provider anticipates an eventual need to help the plan sponsor merge the retirement plans of several organizations, it can accentuate its capacity for doing so – even if this capability was not specifically addressed in the RFP questionnaire.

Similarly, if a little digging were to reveal that the plan sponsor’s employee population is, on average, nearing retirement age, a service provider might highlight (succinctly) its retirement planning education services. Service providers that demonstrate the capacity to be proactive in identifying sponsors’ needs – particularly needs not highlighted by the sponsor in the RFP – will have an advantage over their competitors.

Finally, if a service provider has recently gained new capabilities, it should make those known, especially to
consultants representing plan sponsors, independently of the RFP process. Consultants strive to keep track of service providers and use that knowledge to determine which ones should receive RFPs. They want to be sure to include all the best prospects on the RFP distribution list, and welcome receiving unsolicited capability updates from service providers.

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