

TIMELY TOPICS OF INTEREST TO RETIREMENT PLAN AND ENDOWMENT FIDUCIARIES

# The FIA Perspective

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## 401(k)s to Stay, But Expect Changes

By: Alison Cooke, PlanSponsor Magazine

***“Those in Washington are asking fundamental questions about the retirement plan industry, questions that have not been asked in a long time, including ‘whether what we do works’,” said Brian Graff, ASPPA Executive Director and Chief Executive Officer.***

The issue of retirement security is now the third most important issue in Congress. However, Graff said, speaking at the ASPPA 401(k) SUMMIT in March, making the top three in Congress is not a good thing, “it means a lot more scrutiny.”

Congressman George Miller (D-California), despite being outspoken on many issues surrounding retirement programs, is committed to leaving the 401(k) plan intact, Graff said, saying that in February Miller was cited as saying “we must preserve and strengthen 401(k) plans.”

Graff said that he believes it is vital to keep the 401(k) plan in place, because the 401(k) is the only thing that has ever gotten working people to save for retirement; data from the Employee Benefit Research Institute show that when workers making \$30,000 to \$50,000 are covered by an employer plan, 75.3% of them save but, when not covered, less than 5% of workers save. Further, the 401(k) primarily benefits the average worker, as the vast majority of participants make \$150,000 or less.

“No one is getting rid of 401(k) plans, you can count on it,” Graff said, “but that’s where the guarantees end.” Graff said he expects that the 401(k) construct should remain the same; the exclusion from income is not really being challenged, but the rules governing 401(k)s will certainly be examined.

The buzz on Capitol Hill today is “401(k) reform,” he said. So, advisers can expect that the discrimination rules and tax advantage status will remain intact but, “once the money is in the plan, all bets are off.”

### Fee Disclosure

The new Department of Labor is taking a look at the 408(b)(2) regulations that were not finalized by the previous administration, Graff said. “If the only thing that happens to us is to show a little more fee disclosure...crack open the champagne,” he noted, saying this is only one of many things he expects will be passed.

He noted that although he expects the rules to be finalized by the end of this year, the rules that were proposed under the Bush administration will not be those that will be finalized by the Obama administration. Graff said he anticipates that the new rules will require more transparency than the originally proposed rules, and may require some unbundling because Graff said he predicts fees will likely be divided into three buckets: investment fees, administrative fees, and transaction fees.

***“Our mission is to provide customized consulting services to assist our clients in achieving their investment objectives, while fulfilling their fiduciary obligations.”***

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## EDUCATIONAL ENDOWMENTS' INVESTMENT RETURNS WERE -24.1% IN THE LAST SIX MONTHS OF 2008

*Asset Allocations Showed Continuing Shifts as a Result of Market Turmoil and Valuation Lags*

Source: Commonfund Institute

Colleges, universities and independent schools saw the value of their endowments decline sharply in the six months ended December 31, 2008, reporting an estimated average total return of -24.1 percent, according to the 2009 Commonfund Benchmarks Study® Year-End Update. The Update examined returns and asset allocation among 235 of the 629 institutions that participated in the 2009 Commonfund Benchmarks Study® of Educational Endowments.

“The last three months of 2008 were a period of tremendous stress for endowment trustees, investment committees and staff,” said John S. Griswold, Executive Director of Commonfund Institute, which sponsors the Benchmarks Study. “As institutions review the challenges to their budgets and missions, it will be more important than ever to focus on the key points of investment policy, governance, and spending practice.” Returns for institutions participating in the Update ranged from -21.7 percent among endowments with assets over \$1 billion to -30.2 percent among institutions with assets under \$10 million. “While large institutions did better on a relative basis, none were immune to the market dislocations,” said Griswold. Public and private colleges and universities suffered the least damage in relative terms, with returns of -23.6 percent and -23.7 percent, respectively, while independent schools had somewhat greater losses, with returns of -25.1 percent.

### **Asset Allocations Continue to Shift**

The Update showed that the asset allocation shifts noted in the main Benchmarks Study continued through the first half of FY2009. Less-liquid investment strategies such as private capital, where the timing of marks-to-market typically lag by one or two calendar quarters, were slower to reflect the market declines. As a result, domestic equities, which made up 23 percent of total institutions' portfolios as of June 30, 2008, declined to just 17 percent by December 31, and international equities fell to 15 percent from 18 percent. Fixed income allocations rose to 13 percent from 12 percent, while cash increased to 4 percent from 1 percent. Alternative strategies allocations, responding to the declines in the other asset classes, increased to 51 percent from 46 percent. Viewed over the course of the 18-month period that began on July 1, 2007, alternative strategies allocations increased 9 percentage points, to 51 percent from 42 percent. These trends were more pronounced among the largest endowments and the top decile and top quartile performers, where alternative investments as of December 31 were 57 percent, 63 percent and 58 percent, respectively. At smaller endowments, lower allocations to alternative strategies meant that these trends manifested themselves less strongly. Among alternative strategies, asset allocation shifts were more muted. Marketable alternatives (a category that includes hedge funds, absolute return strategies, market neutral strategies, long-short equity, 130/30, event-driven strategies and derivatives) declined from their June 30 level, going to 40 percent of the allocation from 42 percent, but were still higher than allocations to private equity (including LBOs, mezzanine debt, M&A funds and international private equity), which declined to 18 percent from 19 percent. Private equity real estate accounted for a 12 percent share, down from 16 percent on June 30; energy and natural resources were stable at 14 percent, and venture capital rose to 9 percent, up from 7 percent. Perhaps not surprisingly, distressed debt (which in many portfolios may be part of an overall credit strategy) advanced strongly, rising to 7 percent of the allocation from 2 percent.

### **Benchmarks Leaders**

As in other Benchmarks reports, the Update also included an analysis of the top decile (top 10 percent) and top quartile (top 25 percent) performers in the survey population. The objective of this analysis is to allow educational institutions to gain insight into the practices and policies of their “best of breed” peers. Top decile institutions in the Update returned -16.2 percent in the first six months of FY2009, down sharply from their return of 4.7 percent in FY2008, while top quartile institutions returned an estimated average of -18.6 percent, another significant reversal from last year's 2.4 percent.

*(continued on page 3)*

# 401(k)s to Stay...(continued from cover)

## Target-Date Funds and QDIA Rules

The issue of appropriateness of investments in retirement plans is a large one in Washington, Graff said. One area where advisers can expect to see changes is surrounding target-date funds, Graff said. Those in Congress are scrutinizing 2010 target-date funds, specifically the equity exposure. This is “about the fact that [at an age] close to retirement, people lost money,” he noted.

Along with the examination of target-date funds, Congress and the regulators will likely completely reexamine the qualified default investment alternative (QDIA) regulations and possibly reopen them. That investigation is going to start at hearing in April about target-date funds. Graff said outcomes of the hearing may be that Congress will define what a target-date fund should look like or that a board of experts will define what allocation and investment methodology should look like for a fund to be

blessed as a QDIA. Further, Graff said he can almost guarantee that a stable value fund will be added to the QDIA rules.

Another investment area is that of index funds and their use in retirement plans. Graff said he thinks there will be a push to make index funds required in retirement programs and there will also be a push to determine what you shouldn't have in a plan.

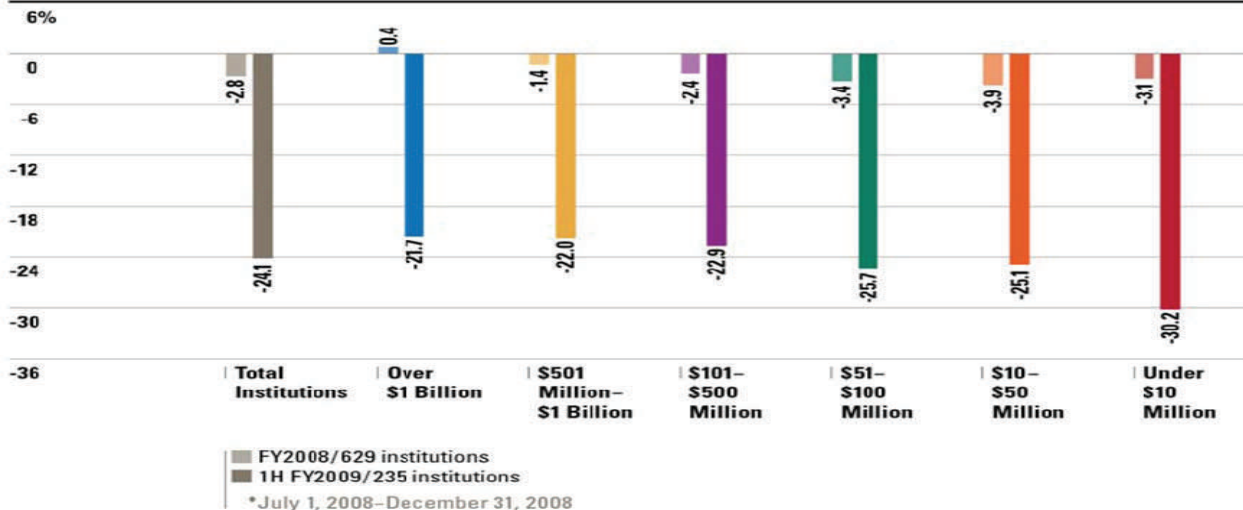
There are a number of proposals in play to promote annuities, he said. There are currently three forms of proposals: a mandate that all defined contribution plans have an annuity as a distribution option, that the default distribution option for defined contribution plans is an annuity but participants have the right to opt-out, or the most extreme proposal would be a mandated distribution of an annuity at retirement that participants must invest in for 24 months and then can choose to opt out.

# Educational Endowments’...(continued from page 2)

Examining asset allocation shifts among the Benchmarks Leaders, top decile institutions on December 31 allocated 63 percent of their endowment assets to alternative strategies, compared with 57 percent as of June 30; for the top quartile, the allocation was up to 58 percent from 54 percent. These allocations compare with 51 percent for the Update population overall, which was up from 46 percent as of June 30. Conversely, the Benchmarks Leaders predominantly had smaller December 31 allocations to domestic and international equities and fixed income securities. Cash allocations were 5 percent for the top decile and 4 percent for the top quartile, as compared with 4 percent for Update respondents overall.

**Net Investment Returns for FY2008 and the First Six Months of FY2009\***

*Numbers in Percent (%)*



## Fiduciary Investment Advisors, LLC

100 Northfield Drive  
Windsor, CT 06095

Phone: 866-466-9412

Fax: 860-683-4227

On the web: [www.fiallc.com](http://www.fiallc.com)

### To contact one of our consultants:

#### Mark Wetzel, President

(860) 697-7410, [mwetzel@fiallc.com](mailto:mwetzel@fiallc.com)

#### Michael Goss, Executive Vice President

(860) 697-7411, [mgoss@fiallc.com](mailto:mgoss@fiallc.com)

#### Karen Paulson, Principal

(860) 697-7413, [kpaulson@fiallc.com](mailto:kpaulson@fiallc.com)

#### Christopher Kachmar, Principal

(860) 697-7412, [ckachmar@fiallc.com](mailto:ckachmar@fiallc.com)

#### Anthony Tranghese, Principal

(860) 697-7414, [atranghese@fiallc.com](mailto:atranghese@fiallc.com)

#### Ryan Gardner, Principal

(860) 697-7416, [rgardner@fiallc.com](mailto:rgardner@fiallc.com)

#### William S. Peck, CFA, Consultant

(860) 697-7438, [wpeck@fiallc.com](mailto:wpeck@fiallc.com)

#### Christian S. Coleman, Dir. of Sales & Marketing

(860) 697-7432, [ccoleman@fiallc.com](mailto:ccoleman@fiallc.com)

Welcome New Clients  
We are pleased to welcome the following  
new institutional clients to FIA:

American School for the Deaf  
(endowment)

Convatec, Inc. (401(k))

ProHealth Physicians (401(k))

Trustees of the Colt Bequest, Inc.  
(endowment)



## FIA News

\* We are thrilled to announce that FIA has been selected by *PlanSponsor* Magazine as the **Retirement Plan Adviser Team of the Year!** This award acknowledges “the contributions of the nation’s best financial advisers in helping make retirement scrutiny a reality for workers across the nation.” FIA was chosen from a pool of more than 550 nominations and selected from five finalists. We are honored by this recognition and grateful for all the support we receive from our clients and friends.

\* FIA is pleased to announce that Teresa Trice and Katie Marino have joined the FIA team. Teresa most recently worked at UBS, and Katie was with UnitedHealth Group. Please join us in welcoming Teresa and Katie!

\* FIA is proud to support and participate in the **CUPA-HR Eastern Region Conference!** The conference was held at the end of April in Providence, RI.

### \* Speaking Engagements:

Bill Peck gave a speech to **The Boston Security Analysts Society** in March, entitled “*Alternative Investments & Asset Allocation: A New Reality?*”.

Mark Wetzel spoke on a panel at the **CPPF Forum** in April on the topic “After Madoff, How Do You Protect Yourself?”.

**FIA celebrated its third anniversary on April 25, 2009!**