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ICG TIMELY TOPICS

From The Top

Milton Friedman wrote a book Free to Choose: a personal statement about the relationship between economics and freedom. The table below is from that book.

You are the spender Whose Money	On Whom Spent	
	You	Someone Else
Yours	I	II
Someone Else's	III	IV

- I. Strong incentive to get highest value on your money (spent on yourself)
- II. Still high value (example: Shop for presents)
- III. No strong incentive to keep costs down, but strong incentive to get your money's worth. Someone else's money spent on yourself (example: company expense account)

One of the most common client statements I get, from both Democrats and Republicans, refers to our Government's "Welfare State." Using the above chart let's review the definition of a welfare state.

All welfare programs fall into either Category III (social security) or IV (public housing). These two categories share one feature, and that is that the bureaucrats that administer the programs partake of the 'lunch.' All Category III programs have bureaucrats among their recipients. This does not imply any opinion of Investment Consulting Group, Inc., but is meant to provide one person's (Friedman's) explanation of how a welfare program works.

For any of you that have had a teenager at home you can probably recognize this behavior, something I can say that I have personally experienced! ☺

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Source: DOL Bureau of Labor Statistics SSA *"The crisis by the numbers"* Pensions & Investments April 18, 2005 p. 14

Number of full time US workers (2004) 132 million	Projected number of retirees and survivors receiving benefits (2015) 50.1 million (2040) 78.3 million	Number of workers supporting each Social Security recipient. (1950) 16.0 (2004) 3.3 (2040) 2.0
Percentage of private work force covered by retirement plans (1999) 50%	(1980) 39%	Number of corporate defined benefit plans (2003) 29,512 (1985) 112,208
Percentage of private work force covered by DB plans (1980) 28%	(1999) 7%	Number of multi-employer defined benefit plans (1999) 1,727 (1980) 2,332
Total under funding of corporate DB plans (2004) \$450 billion (2003) \$350 billion	Total under funding of multi-employer DB plans (2004) \$150 billion (2003) \$100 billion	Number of 401(k) Plans (2004) 409,300 No. of employees covered by 401(k) plans (2004) 50.4 million Average 401(k) balance (2004) \$40,000 Average 401(k) deferral rate (2004) 6% Average corporate match (2004) 3%

**Editorial Staff “*Young workers hungry for retirement plan information*” Employee Benefit News
April 15, 2005 Vol. 19 No. 5 pp. 16, 21**

Fully 93% of workers between the ages of 19 and 26 believe 401(k)s and other employee-funded retirement plans are an important benefit, finds a survey of 1,201 full-time employees. At the same time, however, just 37% of this so-called “echo boomer” generation – those born between 1982 and 1995 – participates in such a plan when it is offered, compared with 75% of Gen Xers and 85% of baby boomers.

Many companies fail to connect with young workers, the survey data suggests. Just 37% of echo boomers say their employer provides enough information about the retirement plan, compared with 58% of Gen Xers and 61% of baby boomers. As the proportion of young workers grows, 401(k) sponsors may find it harder to pass annual non-discrimination tests if these employees don’t enroll in the plans. Some 48% of echo boomers say they’d rather not think about retirement investing until they get older, which suggests they’re swamped with competing financial priorities. They are just getting started with life and are looking at all sorts of bills like student loans, rent, car payments and car insurance.

To attract younger workers, financial advisers need to move beyond a one-size-fits-all approach to retirement savings education. One of the most important financial concepts to hammer home to young workers, who have more time than money, is the value of compound interest over time. These employees will also benefit from a discussion of how tax advantages take the sting out of 401(k) investing. Echo boomers are more likely than workers in other generations to have merely guessed how much they’ll need in retirement, rather than trying to figure it out through worksheets or calculators. Perhaps that’s why they think they’ll need much less retirement savings on average (\$536,000) than do Gen Xers (\$938,000) or baby boomers (\$832,000).

Young workers are also most likely to believe their companies aren’t concerned with their retirement security or aren’t operating the retirement plan in their best interest. Firms may also win trust by providing sample statements and informing workers about the disclosure requirements associated with their 401(k) plan.

Editors “*Sponsors feel consulting fees are low, survey says*” Pensions & Investments May 2, 2005 p. 27

Plan sponsors are reporting that fees paid to investment consultants are low, according to a recent survey on the consulting industry. The survey found that plan sponsors believe consulting fees have been chronically low for several years; as sponsors seek more research and guidance in areas like alternative investments and governance, consultants deserve greater compensation for their expertise. Consulting firms have a tremendous opportunity right now to provide their clients with additional educational and informational services. The bad news for a number of investment consulting firms is that the Securities and Exchange Commission’s pay-to-play probe is still a lingering question mark. Despite the investigations, plan sponsors believe investment consulting firms aren’t charging enough for their services – with most plan sponsors saying they are willing to cut their consultants larger checks.

The survey indicates that plan sponsors want their investment consultants to be more intuitive and have greater anticipation of their future needs. Plans also say they have a greater need for consultants to provide them with liability analysis, board governance guidance and investment advisory services – especially in the area of alternative investments. Over the last several years, we have seen more consulting firms offering fee-based services for additional or specialized advisory work. It’s a good model and it shows that consulting firms are maturing, but to succeed with this you can’t just be a ‘yes’ firm. Almost one-quarter of plan sponsors believe their consultants are reacting to client needs rather than anticipating them. By being proactive, consulting firms are opening up discussions that not only have the potential to enhance overall client relations, but also could smoothly shift to paid opportunities.

Trone, Donald B. “Asset allocation is as much an art as a science” Investment News Vol. 9, No.14, April 11, 2005 p. 21

It's the fiduciary's duty to diversify a client's portfolio prudently to a defined risk/return profile appropriate to the client's goals and objectives. In the case of a participant-directed retirement plan, the fiduciary must provide adequate asset classes so that the participant can diversify prudently. The following five questions frame the asset allocation practices: 1) *Has a risk level been identified?* A client is far more likely to abandon an investment strategy for its volatility than for any other reason. 2) *Has an expected, modeled return to meet investment objectives been identified?* The fiduciary is required to state the presumptions that are being used to model the probable outcome of a given investment strategy. 3) *Has an investment time horizon been identified?* It is important that the fiduciary prepare a schedule of a portfolio's cash flows so that the fiduciary can determine the point in time when more money is flowing out of a portfolio than coming in. 4) *Are selected asset classes consistent with the identified risk, return and time horizon?* The fiduciary's role is to choose the appropriate combination of asset classes that optimizes the client's identified risk and return objectives, consistent with the portfolio's time horizon. 5) *Is the number of asset classes consistent with portfolio size?* There is no formula the fiduciary can follow to determine the best number of asset classes; the appropriate number is determined by facts and circumstances. The fiduciary has a duty to diversify a portfolio prudently; it is not something the fiduciary can choose to do or avoid.

Crawford, Gregory “SEC puts securities lending on list of things to watch” Pensions & Investments May 2, 2005 p. 31

Add securities lending to the list of things on the Securities and Exchange Commission's radar screen. In its examination of mutual fund market timing and late trading, the SEC found that advisers blatantly put their interests above those of mutual fund shareholders. Mutual Funds are big lenders of securities. While the focus is on securities lending in the mutual fund world, plan sponsors that lend securities also need to be on guard, particularly regarding their relationships with lending agents, custodians and investment managers. In light of their recent experience, the SEC views any place where there is a significant amount of money changing hands as something worthy of their more considered attention than perhaps had been given in the past.

The SEC has gone through late trading and market timing and looking at adherence to fiduciary obligations. Securities lending is the next logical set of transactions to look at. It is seen as an extension of what they've already done. The analogy is similar to when we see advisers who choose brokers. If you're an adviser and you're helping clients choose a broker, you need to do that in a way that's best for clients. You need to do due diligence. It is the same with helping a client choose a securities lending agent. The choice cannot be made just because it is easy. You need to go through a reasonable due diligence process.

One potential area of conflict is in collateral management. The management of collateral is what generates fees. If the risk being taken on the management of collateral is not commensurate with what the client expects, that's a problem. The conflict may be the lending agent takes risks because they share in the income earned from those investments. The agency has not uncovered that sort of wrongdoing but was on the lookout for it. Other areas of focus include how securities lending clients – beneficial owners – are treated by their agents. Also the commission will examine the communications between portfolio managers and securities lending officials to determine whether the securities lending activities are putting undue strain on the portfolio manager. The real focus is on the core investment strategy. Our concern is if the securities lending activity is putting limitations on the core strategy or the ability to implement the core strategy. The idea of fundamental fairness is a positive for the industry. More transparency in the lending market and a firmer grasp of the risks are necessary goals for everybody in the industry.

**Anand, Vineeta “SEC ‘sweep’ takes legal aim at investment consultants” Pensions & Investments
May 16, 2005 pp. 1, 26, 27**

The Securities and Exchange Commission is planning to take legal action against many investment consultants for violating securities laws, and is expected to ask several others to beef up their compliance procedures and policies and their ethics codes to prevent or disclose conflicts of interest to their clients.

Specifically the SEC’s sweeps found the following: 1) More than half of the consultants or their affiliates examined regularly provided services and products to both pension funds and money managers/mutual funds, and many earned a “significant part of their annual revenue” from dealings with the latter. 2) More than half host investment conferences where money managers and their clients are both present. The money managers typically pay thousands of dollars for such conferences, while plan sponsors attend for free. 3) Ten of the consultants sell performance analysis software to money managers for fees as high as \$70,000 annually. 4) A majority of the firms have affiliations with brokerage houses or relationships with outside broker-dealers that have raised concerns about whether clients are getting best execution on trades, whether pension plans are paying too much in fees, and whether the pension plans’ assets are being traded more frequently than they should. 5) Two also had relationships with unaffiliated brokerage firms that they did not disclose to their clients. 6) Some consultants had recommended money managers that purchased products and services from them more frequently than they recommended those that did not. 7) Many also have affiliates that provide services, such as investment management, performance analysis or transition management, to pension plans. 8) Many consultants failed to maintain policies and procedures that enable them to prevent or manage conflicts of interest.

The SEC’s findings have been shared with the Labor Department’s pension office, which is considering offering guidance to plan sponsors and trustees on their fiduciary responsibility to ask consultants hard-hitting questions about real or potential conflicts.

**Miller, Rick “Fee-based advisers face 401(k) boom” Investment News Vol. 9, No. 19, May 16, 2005
p. 18**

The prospect for advisers who deal in 401(k) plans to take over business from existing plan providers has reached a high point. An adviser prospecting service that polls about 800 plan sponsors a week, finds that the number of employers that might switch or are actively searching for a new provider is at or near record levels. It’s really particularly good for those advisers that are fee based. The reason is because fee based implies better disclosure, and that is what people want. People are shopping; it is unknown how many are changing, but they are shopping.

Increased awareness by plan sponsors of their fiduciary duties also is making them take a closer look at their plans. Concerns about fees and disclosure are also leading them to see if they can do better. They are finding that prices have come down and they have a significant opportunity to renegotiate their plan or, if they move, to save a lot of money. The anecdotal evidence from financial advisers backs up the findings that plan sponsors are more open to changing providers.

Brokers, typically wirehouse brokers, aren’t performing the level of service required in qualified plans. Some brokers are opening the door for other advisers. One small plan, a couple of million dollars, hadn’t seen their broker in two years. They were getting no education, no due diligence, no investment review, no investment policy statements, and 90% of the time, in that marketplace, that is what you find.

Miller, Rick “Are 401(k) advisers plan fiduciaries?” Investment News Vol. 9, No. 11, March 21, 2005 pp. 3, 53

A soon-to-be-released survey of individual advisers to 401(k) plans shows that while a majority view themselves as fiduciaries, many doubt their broker-dealers see it that way. Industry experts say there is a gap between the opinions of broker-dealer registered representatives who are trying to meet the demands of plan sponsors and the opinions of their own home offices, which fear lawsuits because of fiduciary liability.

Asked the question: “Do you consider yourself to be a fiduciary to your plans under management?” 63.3% of the reps answered yes, 28% said no, and 8.7% were unsure. A follow-up question asked: “Does your broker-dealer or licensing organization consider you to be a fiduciary to your plans under management?” Half of the 63.3%, or 31.5%, answered yes, 40.2% said no and 28.3% were unsure. Of those advisers questioned, 29% were with wirehouses, 7% with regional brokerage firms, 19% with insurance-affiliated broker-dealers and 45% with non-insurer-owned independent-contractor broker-dealers. Broker-dealers tend to say to their brokers and their investment advisers, “We do not want you to be a fiduciary under ERISA; don’t become one.” It is easy to say that, as a prohibition, but it is difficult to make it stick if the adviser really is providing investment advice for compensation. Under the Employee Retirement Income Security Act (ERISA), if reps give advice and are compensated for it, they are acting in a fiduciary capacity. There is a growing recognition within the brokerage and financial advisory community that, yes, they probably are fiduciaries. There is still somewhat of a head-buried-in-the-sand approach by the firms themselves as to what their brokers really are doing. Trade associations representing broker-dealers don’t see it that way. The advisers are wrong to think that they are fiduciaries. Reps aren’t fiduciaries, because they are not really giving advice to plan participants on plan assets; they are merely selling and installing a plan.

Broker-dealer firms have to absolutely make sure in what capacity they are providing service to those plan sponsors. Firms for instance, offer services to plans, such as quarterly review of plan performance, but won’t recommend funds to replace under-performing ones. That would be advice and put them under ERISA. Sponsors don’t view advisers as “salesmen selling a product.” Plan sponsors want fiduciary-responsibility sharing; that’s why they are paying these people. Otherwise, they could pick up the phone and buy a plan off the shelf. What they are looking for these people to do is help make these decisions, and these advisers are saying, “That’s what we do.” Part of the problem is that 401(k) providers tend to be retail oriented.

Asked the question, “Do you disclose your compensation to your plan sponsors?” 85.7% of advisers said yes, and 14.3% said no. The results aren’t clear as to whether advisers were making the disclosure when pitching to new clients or to all existing clients. To the question, “Do you want your provider to disclose their fees to your plan sponsors?” 90.3% replied yes, and 9.7% said no. There are those that are skeptical that more than 85% of reps disclose their compensation.