

**2003 AIMSE Conference**  
**Past, Present and Future – A Fresh Look at the Rapidly Changing**  
**401(k) Market**  
**May 6, 2003**

**Moderator:** Russ Shipman, Vice President and Director, *Janus Institutional*

**Panelists:** Tom Pittman, *Automatic Data Processing (ADP)*

John (“Rick”) Rockwell, Senior Vice President and Director of T. Rowe Price Retirement Plan Services, Inc., *T. Rowe Price Associates*

Jane Farris, Manager of Pension Fund Investments, *Sandia National Laboratories*

**Tom Pittman, ADP**

ADP Retirement Services is a mass-market, lowest-reasonable-cost provider of bundled retirement plan programs. The company has four service centers organized around market/products, shared technology, resources and expertise.

<b>Service Center Location</b>	<b>Product</b>	<b>Target Market</b>	<b>Approach</b>
Roseland, NJ	Small Market, Simple IRA, Safe Harbor k, 401(k)	< 100 Participants < \$3 M Assets	Bundled Program
Louisville, KY	Mid Market 401(k), PS, MP	100 – 1,000 Participants \$3 M - \$50 M Assets	Flexible Bundled
Deerfield, IL	DC Custom Market	10,000+ Participants > \$250 M Assets	Custom
Seattle, WA	Large Market Non-Qualified	10,000+ Participants > \$50 M Assets	Custom

ADP Retirement Services Vision: To be the leading distributor of tax-advantaged savings programs that allow working Americans to provide a better life for themselves and their families.

Universal Propositions:

- Payroll Integration
- Full Service Offering
- Simplicity & World Class Service
- National Enrollment Team
- Account Rebalancing
- Advice Offering
- Timely & Accurate Reporting
- Broad Multi-Manager Investment Menu

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ADP Constituents and Value Propositions for Each:

- Alliances & Acquisition Prospects – help grow their businesses through support for advisors
- Financial Intermediaries – provide support at point of sale and enrollment
- Plan Sponsors – provide an entire 401(k) solution
- Participants – help participants focus on their retirement future with high-touch, high-tech assistance

The entire U.S. retirement market totaled \$10.9 trillion in 2001. Asset growth rates were negative in all retirement markets in 2001.

- The DB market suffered the biggest loss with a 10.2% drop in assets; 401(k) and DC markets followed, taking a loss of 5.8% and 5.5%, respectively
- The IRA market suffered only a 2.8% drop

ADP expects to see two major shifts in the industry as the baby boom generation nears retirement:

1. Distribution levels will rise – by 2030, 20% of the workforce will be in retirement
2. Product focus will change – providers will shift from asset accumulation products to rollover and wealth preservation products and services

New legislation that allows for increased contributions may boost asset growth and postpone the effect of the aging workforce.

**Projected and Historical Retirement Market Growth Rates**

Plan Type	Assets (Billions)	5-Year Historical Growth Rate	5-Year Projected Growth Rate
DB	\$4,530	5.0%	5.0%
IRA	\$2,885	12.0%	12.0%
401(k)	\$1,638	8.5%	12.0%
Simple IRA	\$ 130	n/a	18.0%
401(a)	\$ 980	11.5%	12.0%
403(b)	\$ 500	6.5%	9.0%
Keogh	\$ 95	8.0%	9.0%
457	\$ 80	6.0%	9.5%
Federal	\$ 100	n/a	n/a

Data from analysis performed by Cerulli Associates

Five providers control 55% of all 401(k) assets under administration: Fidelity; Hewitt Associates; Citistreet; Vanguard and Mellon. Their dominance, however, is restricted to the “mega market” (10,000+ EEs).

Industry acquisition activity is accelerating. The number one challenge is profitability. Competition has kept prices for recordkeeping services below, in many cases, the cost of service delivery. The formation of alliances of investment firms and efficient record keepers is accelerating.



Q: Why are so many companies taking away their matches on their 401(k) programs?

R: Companies are struggling to survive and benefits are a luxury. Forecasts for the 401(k) market slowdown take that into account. Employer contribution decreases are offset by employee contributions. Elected deferral contribution limits have jumped from \$10,000 in 2001 to \$11,000 in 2002, and will go to \$12,000 in 2003.

### **Rick Rockwell, T. Rowe Price**

Rick is head of DC sales. T. Rowe Price has offices in Baltimore and San Francisco and a small presence in both Long Beach and Colorado Springs. Most of the sales people are based in Baltimore.

T. Rowe Price administers \$63 billion in DC assets and has 21 years in the business. Their DC Plan Services division has 950 employees, including 20 salespeople. T. Rowe Price has separate sales forces for DB and DC. Keith Lewis is head of DB Sales. The firm took three of their senior DC people and shifted their focus to DB. The firm has not yet gone to a profitability-based compensation model. On the full-service side, the client service side controls pricing and profitability.

Rick's sales vision is never to be surprised in the marketplace, and be part of every "contest" that is of interest to them. He believes that there is a good chance that all the non-investment record keepers, except ADP and Hewitt, will go away.

- Company stock is still an issue, but is fading as a discussion topic
- The public defined contribution business is not easy to penetrate
- On the DC side, no one is sitting there waiting to take your call. There are many users involved in the DC buying process – economic, technical and day-to-day end-users.

### The Past

- Explosive growth
- Mutual funds
- Opportunities galore
- Bundling...a marketing expense
- Open architecture...say what?

### The Present

- Mega (full-service) market is gone, large market is maturing – not a lot of turnover, fewer players, everyone has their recordkeeping act together
- Search activity has been down, especially since 9-11
- Open architecture
- Consolidation
- Fee pressure
- The regulatory environment is brutal and will get worse
- Advice

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- Total Retirement Outsourcing (DC provider does DB plan too)/Total Benefits Outsourcing
- Best in class (achievement, not aptitude test)

#### The Future

- Staffing
- Consultants (70% consultant driven)
- Clients
- Public market (87% of assets are DB; corporate is 50% DB/50% DC)
- Paying to play
- Wholesaling
- If you are I.O. (investment-only), opportunities abound
- Selling and solutions are, as always, essential

#### **Jane Farris, *Sandia National Labs***

Sandia is the #189 plan on P&I's top 1,000 plan list with over \$4 billion in DB and DC assets. Sandia has 8,000 employees, including 1,500 Ph.D. physicists and engineers and has 5,000 retirees. Sandia's programs are funded primarily by DOE and managed by Lockheed Martin. Sandia National developed the foam used after 9-11 to kill the anthrax virus, as well as the sniffer devices used at airports to detect explosives. It's a chemical lab on a computer chip.

They are a company of super savers. Her mission is to provide opportunities for participants to build wealth. Cost reductions factor into that. Jane would like to see more disclosure about revenue sharing. Sandia has both a DB and DC plan, the latter of which started in 1993 when Lockheed Martin began managing the Laboratory. They have the same committee for both DC and DB plans' investments. The participants' assets have been flowing into conservative funds. Thirty percent is in a stable value fund, which is 1 of 18 funds available to participants. Sandia focuses on the 401(k) as a wealth-building vehicle. Jane focuses closely on fees and what they take away from what the participants will earn.

#### The Goal

- Attract and retain the best employees
- Provide competitive benefits
  - Create wealth-building savings vehicle
  - Provide broad array of options to fit needs
  - Cover the risk spectrum
  - Provide education

#### Sandia's Philosophy on Investments

- Past performance isn't predictive
  - Know the investment manager well
  - Objective evaluation is key
  - I.D. repeatable value added

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- You can't time the market
  - Strategic allocations
  - Long-term positions
  - Evaluate managers over longer periods

Sandia uses a systematic approach in selecting investment options. They have an Investment Policy Statement for both DC and DB plans. They're looking for:

- Value added that is repeatable
- Products that fit the plan's needs – systems and funds
- Reasonable fees
- Organization that values their people – strong bench, stable organization, shared values
- Good, repeatable performance as a result of a good process
- Understanding of impact of transactions on rates of return
- Knowledge that size of assets under management matters

#### Sandia's Wish List

- More institutionally-priced funds
- Revenue sharing disclosures
- Cost-based revenue sharing
- Tools that matter: long-term savings and wealth building
- Access to portfolio managers and other expertise
- Burger King, not McDonald's ("Have it Your Way")
- Ease of including non-proprietary funds
- Eyes on technology and systems

#### Issues

- Excessive trading by participants
- Gaming funds
- Advice, or lack thereof
- Bush's proposed savings vehicles