

Money Management Executive

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Covering Mutual Funds, SMAs, 401(k)s, 529s & More The Newsweekly of Insight & Strategies

At Deadline

NASD Fines Alliance, Putnam, Scudder \$700,000

By Lee Barney

The NASD has fined AllianceBernstein, Putnam Investments and DWS Scudder a total of \$700,000 for improperly paying for entertainment and guest expenses at training and education meetings.

Scudder is paying \$425,000, Putnam \$175,000 and Alliance \$100,000, although none of the firms admitted wrongdoing.

One of the parties that Scudder held was in 2002, where the firm recreated a 1970s discotheque. The firm also held fishing, golf and horseback riding events and lavished brokers and their spouses with dinners at expensive

Regulation & Compliance

At Deadline, cont. on page 3

Responding to the 'PowerBoomer' Surge

Capturing Rollovers Means Providing More than Mutual Funds

By Hannah Glover

As the so-called "PowerBoomers" approach retirement, a surge of assets will begin leaving retirement plans and flowing into the open market.

And as they retire, this group, now between the ages of 40 and 60 with between \$1 million and \$2 million in assets, are likely to shed 25% of their advisers, according to Laura Varas, president of Mast Hill Consulting in Hingham, Mass., and research partner with Financial Research Corp. of Boston.

Companies that don't want to be culled will have to do more than provide a place for investors to park their rollover dollars. FRC estimates that between 20% and 40% of all PowerBoomer assets are up for grabs. With investors over 55 controlling 70% of assets to invest, catering to this market is critical.

"Firms that are going to lose are firms that don't necessarily have a retirement focus, and firms that are not cooperating across functions such as investment, marketing, healthcare, banking and estate planning," said Varas, co-author of a recently released FRC study entitled, "Engaging PowerBoomers: Winning Investment Products and Retirement Solutions."

"People look at the next 40 years in retirement and the idea of going it alone

Retirement

POWERBOOMERS, cont. on page 14

The IRA Rollover Race

Page 12

Data Points

2006 Annual Flows by Fund Objective (\$ in Billions)

| Fund Objective | Annual Flows (\$ in Billions) |
|----------------|-------------------------------|
| Corporate | 50 |
| Equity | 15 |
| Government | (20) |
| Intl/Glob | 170 |
| Tax-Free | 14 |

Despite double-digit returns in the domestic market in 2006, international funds continued to outsell and outperform the average domestic equity fund. Net sales of international funds were over \$170 billion, up from \$139 billion in 2005.

Source: Financial Research Corp.

401(k) Fee Scrutiny Boosts ETFs

If You Can't Join 'Em, Beat 'Em

By Hannah Glover

Despite growing popularity and public awareness, exchange-traded funds still struggle to get onto 401(k) and other retirement plan platforms.

But ETF providers aren't waiting around. Instead, companies like Santa Monica, Calif.-based National Planning Corp. have adopted an if-you-can't-join-them-beat-them approach, creating plat-

forms of their own.

"I believe that this initiative will change the way the 401(k) is delivered to plan participants in the future," said Stuart Paris, an NPC representative and president of Great Neck, N.Y.-based Paris International.

The driving force behind platforms for cost-conscious alternative products is investors' increased awareness—and

401(k)s

ETF PLATFORMS, cont. on page 15

Bigger Role Seen for Hedge Funds

By Jessica Papini

Hedge funds are viewed as high-risk investments and the average investor tends to shy away from them. But they can complement and offer diversification in an investor's portfolio, according to a recent Lipper "Research Series" report, "The Role of Hedge Funds and Hedge Fund Like-Mutual Funds in a Portfolio."

"Most people view hedge funds as risky, but in reality, some hedge funds and hedge fund-like mutual funds are not as risky as equity mutual funds," said Andrew Clark, senior research analyst and author of the report for Lipper of New York.

The risks associated with these investments are actually similar to bond mutu-

Hedge Funds

HEDGE FUNDS, cont. on page 16

ETF PLATFORMS

from page 1

regulators' intensified scrutiny—of 401(k) fees.

"Almost all participants in 401(k) plans do not know how to account for soft-dollar fees, 12b-1 fees, variable annuity wrap fees, sub-transfer agent fees or investment management fees that might come out of their assets," said **Chad Parks**, founder and chief executive of **The Online 401(k)** of San Francisco.

Besides 12b-1 fees, some companies choose which share classes to include in their plans based on revenue-sharing agreements, while others create funds-of-funds using proprietary funds only, and still others pass along charges for services meant to be borne by the sponsor—such as advice—to investors in the form of asset-based charges.

Parks this month issued a press release launching "a public crusade to spotlight hidden 401(k) fees."

Parks is not alone in urging investors and their fiduciary sponsors to examine what they are really buying into. The **Securities and Exchange Commission** has probed fee structures for years, while the Pension Protection Act has attracted renewed rhetoric from politicians. Last November, the **Government Accountability Office** issued a report that called for better fee disclosure to be provided to participants and the **Department of Labor**.

For its part, **The Online 401(k)** plans to roll out a rebate program for 12b-1 fees and to adopt a fee structure based on the number of employees, not the assets under management.

When it comes to looking for low-cost tools to include in these plans, ETFs have led the charge.

"With ETFs, all of these hidden fees in mutual funds and other types of products do not exist," Paris said.

Launched nationally last week, NPC's platform is the newest of a cadre of ETF-oriented platforms, such as those from **XTF** in New York and **Invest**

'n Retire in Portland Ore., that looks much like the mutual fund-based retirement models to which investors and plan sponsors are already accustomed.

NPC's product is designed as a collective trust, where assets are held in an omnibus account and priced once at the end of the day. This avoids challenges such as intra-day pricing, prohibitions against buying partial shares and the added wrap-fee applied to ETF-comprised funds-of-funds sold on traditional mutual fund platforms. Targeting small- to mid-size companies with plans under \$10 million, Paris said the structure allows regular investors access to alternative tools that high-net-worth investors have used for years.

"ETFs are going to penetrate all investment vehicles," he said.

Besides the traditional index-based and inexpensive ETFs, NPC's platform includes actively managed products for those searching for added alpha, and ETF-based variable annuity offerings through partnerships with **Avatar Investments** in New York and **Jackson National Life Insurance** in Denver, respectively.

"ETFs are here to stay," Paris said. As a \$400 billion industry, "they are where mutual funds were 20 years ago, and they are exploding," he said.

But the problem is that most sponsors won't offer ETFs until they begin feeling pressure from participants, said **Susan Menke**, a senior financial analyst with Chicago-based financial marketing and research firm **Mintel**.

"And most people don't know what the heck they are," she said. The majority of ETF inflows, she added, are coming from institutional, not retail, investors.

As of December 2005, only 19% of retail investors understood enough about ETFs to even consider investing in them in the future, according to **Mintel** research.

As news of ETFs trickles into the mainstream media, that awareness is

rising, but Menke still does not see a groundswell of pent-up demand. After all, she said, 35% of mutual fund owners told **Mintel** they had no idea which funds they owned.

That's not to say the growth of ETFs will not go unchecked.

"Mutual funds have been the elephant in the room for so long that they've been slow to adopt [alternative products]," Menke said. "In the last year or so, they've been scrambling because they realize that this is a force to be reckoned with."

In some cases, companies that wouldn't put pure ETFs on their own platforms yet, still profit from the growing market by acting as custodians for companies like **XTF** and **NPC**.

Parks is unconvinced that ETFs will sweep the retirement space. "Is it a trend or is it a fad?" he said, "I'm pretty sure it's a fad." Parks warned that the more complex ETF offerings become, such as actively managed ETFs, their low-cost efficiencies are likely to get canceled out.

Compared to actively managed mutual funds, which commonly bear expense ratios between 150 and 200 basis points, the actively managed **Avatar** funds offered by NPC still cost only 75 basis points, Paris noted.

Parks argued that investors need best-of-breed approaches that include not only ETFs and mutual funds, but also managed accounts and even products that perhaps have not even been developed.

Although ETF-based 401(k) platforms may reflect a fad-like fervor for this one particular tool, he said, they do represent a deeper trend: investors' concern over fees cutting into their retirement savings.

And that's an issue that will impact the industry for years to come.

"Regardless of what the underlying investment is, it is the overall cost and performance that matter," Parks said. "We're moving in the right direction, but I don't think we're stopping with ETFs."

