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RISK MANAGEMENT SYSTEM

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THOUGHT LEADERSHIP FOR THE SUCCESSFUL ADVISOR

"Facts are stubborn things, but statistics are more pliable"

Standards-based Investment Analytics & Reporting

Expert Witness Services & Consulting

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Customized Compliance Software

A Prudent Process Can Yield A Different Recommendation –

And Scalable Success for Advisors

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Author:

David J Witz, AIF®, Managing Director
(704) 564-0482
dwitz@fraplantools.com

FACTS ARE STUBBORN THINGS, BUT STATISTICS ARE MORE PLIABLE

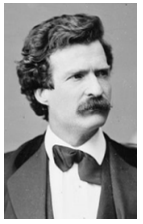
Have you ever wondered whether your investment process yielded an undiscovered investment gem or just another widely recognized investment alternative?

Although investment advisors are engaged to establish a prudent investment selection process that yields investment performance that matches expectations, it is sometimes difficult to avoid following the herd when good investments are obvious to the average observer.

The question is, are good investments easily identifiable by the average observer?

To answer this question, we scanned the PlanTools™ client database and found some surprising answers.

> **"Facts are stubborn things, but statistics are more pliable."**
>
> *Attributed to Mark Twain*



FINDINGS

The **PlanTools™ Risk Management System** contains over 120,000 investment options, which is more than twelve times the number of individual stocks available for purchase. This immense database includes open-end mutual funds, ETFs, indexes, group and individual variable annuity sub-accounts, separate accounts, collective investment funds and custom funds. Of the 120,000 investment options available within the system, approximately 6,900 open-end mutual funds have been used to specifically populate the investment portfolios of retirement plans within the PlanTools™ system. Many of the 6,900 investment options represent multiple share classes of the same investment fund. If you eliminate the multiple share classes, approximately 1500 different investments have been used by retirement plans subject to a prudent investment process and monitoring standards within the PlanTools ™ Risk Management System.

We then analyzed our database to determine how many retirement plans used each of the remaining 1500 open-end mutual funds. To our surprise, very few investment alternatives found their way into the majority of the retirement plans. In fact, only Growth Fund of America, PIMCO Total Return and EuroPacific Growth were utilized by more than 50% of the retirement plans monitored on PlanTools ™ Risk Management System. No other investment was utilized by more than 30% of all retirement plans in the PlanTools ™ database.

PlanTools™ users represent banks, insurance companies, registered investment advisors, broker/dealers, registered representatives, insurance agents, certified public accountants (CPAs), consultants, and third party administrators. As such, our findings are representative of a broad cross-section of industry service providers. It is also noteworthy to mention the investment options cited on the short list of most often used funds are subject to a prudent standards-based selection and monitoring process.

This analysis should not be used to draw the conclusion that popularity is a standard for better investment performance. Our statistics merely reflect the percentage of retirement plans that use an investment fund not the reason why the investment was selected. Therefore, the objectives of the retirement plan and the criteria used to prudently select the investment alternatives were ignored in this analysis.

OBSERVATION: The volume of investment choices is so immense, the only practical way to narrow the field to arrive at a manageable number of qualified candidates for consideration is by using an automated standards-based investment analytics system. Using a system trumps throwing darts as a prudent process every time.

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THE MANUFACTURER'S BLACK BOX

We also note that successful advisors do not rely exclusively upon the investment process or reporting produced by a product manufacturer. Product manufacturers have produced valuable materials to help advisors assess and monitor the product manufacturer's services including the performance of both the proprietary and non-proprietary investments they offer. However, the advisor that blindly relies on a purveyor's in-house research without conducting their own independent objective analysis has relinquished their responsibility to someone with an inherent conflict of interest. Even if the product manufacturer contracts the services of a non-affiliated investment advisor, the non-affiliated investment advisor's loyalty is to the person that has retained them, *i.e.*, the product manufacturer and not the plan sponsor. This structure, with its inherent conflicts, imposes upon a plan sponsor the need to retain an independent objective investment advisor to provide the necessary analytics to support their investment decisions and document a prudent process.

This approach is not a belt and suspenders approach, but instead reflects an understanding that a contract and the loyalties thereof exists between the product manufacturer and the contracted non-affiliated advisor versus the plan sponsor and the product manufacturer's contracted non-affiliated advisor.

Under ERISA, it is of paramount importance that the relationship between the plan and its service providers avoid conflicts of interest and self-dealing. Therefore, it is critical that a plan fiduciary retain an advisor that clearly understands their client is the "participant" and not the plan sponsor or anyone else. Unfortunately, a registered investment advisor retained by a product manufacturer, while beneficial, is potentially a conflicted service provider with loyalties to the product manufacturer and not the plan participants.

Without appropriate guidance by an independent advisor that engages in an objective process, a plan sponsor increases risk of a fiduciary breach. Furthermore, an advisor that is paid an ongoing commission that reduces a participant's accumulated account value without providing any necessary services for the establishment or operation of the plan increases the risk of a fiduciary breach claim for the plan sponsor. Sales commissions reduce participant values, which is permissible if the commission is reasonable for services rendered. However, the tradition of paying unending and increasing commissions to a salesperson who delivers no services to the plan after the sale of the investment product subjects the plan sponsor to risk of a fiduciary breach claim for excessive fees.

OBSERVATION: If the product manufacturer does all the work, the advisor is no longer necessary and payment to an advisor is not longer reasonable!

Fun Fund Facts

The Most Popular Funds

Fund Name	Investment Category	Usage
American Beacon Large Cap Value	Large Value	20-25%
Growth Fund of America	Large Growth	70-75%
Davis NY Venture	Large Blend	25-30%
Schwab S&P 500 Index	Large Blend	20-25%
Goldman Sachs Mid Cap Value	Mid-Cap Value	15-20%
Columbia Acorn	Mid-Cap Growth	15-20%
Ariel	Mid-Cap Blend	10-15%
Dreyfus MidCap Index	Mid-Cap Blend	15-20%
Northern Small Cap Value	Small Value	5-10%
Baron Small Cap	Small Growth	20-30%
Keeley Small Cap Value	Small Blend	15-20%
Dreyfus Small Cap Stock Index	Small Blend	10-15%
American Balanced	Moderate Allocation	15-20%
American Funds Capital World G/I	World Stock	20-30%
Oakmark International	Foreign Large Value	15-20%
Artisan International	Foreign Large Growth	15-20%
EuroPacific Growth	Foreign Large Blend	50-60%
DFA Intl Small Cap Value I	Foreign Small/Mid Value	0-5%
MFS International New Discovery	Foreign Small/Mid Growth	0-5%
Oppenheimer Developing Markets	Diversified Emerging Markets	0-5%
American High Income Tr	High Yield Bond	5-10%
PIMCO Total Return	Intermediate-Term Bond	50-60%
Loomis Sayles Bond	Multisector Bond	0-5%
PIMCO Real Return	Inflation-Protected Bond	10-15%
Schwab Investor Money	Money Market Taxable	15-20%
MetLife Stable Value	Stable Value	15-20%

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MERITS OF AUTOMATION

Asset allocation is the primary benefit of pooled investment funds such as mutual funds and supports an argument for diversification to minimize the risk of large losses as required under ERISA § 404(a)(1)(C). Empirical evidence also exists to support diversification among asset classes and asset categories to maximize return potential, minimize risk and meet the prudent man standard under ERISA.

Building diversified portfolios to meet the prudent man standard of ERISA and minimize the risk of large losses requires more than a random process. To build a portfolio that successfully meets both objectives depends upon the evaluation of many variables in comparison to an enormous database of competing peers. Qualified advisors have met this challenged by combining their intellectual expertise with effective technology to increase efficiencies and accuracy. Without the appropriate technology to evaluate and monitor the investment portfolio, an advisor is at a distinct disadvantage to support a comprehensive investment process that meets the prevailing circumstances of a prudent man.

Automation also protects the advisor and plan sponsor from failing to follow the proscribed investment monitoring process established in the Investment Policy Statement (IPS). When the IPS and monitoring activities are decoupled, advisors and plan sponsors increase the risk of failing to adhere to the IPS as written. Failure to adhere to the governing plan documents is a fiduciary breach under ERISA §404(a)(1)(D).

Unfortunately, many plan sponsors retain the services of generalists that can sell an investment product but cannot provide necessary services. However, ERISA imposes a high standard on plan sponsors to retain experts where the needed expertise is lacking. In short, the ERISA prudent course of action dictates a plan sponsor hirer a specialist not a generalist, especially a generalist retained by relationship instead of a documented prudent process. [*See the ERISA Advisor Evaluator (EAE) for selecting Qualified Advisors*]

Finally, a plan sponsor should determine whether an advisor subscribes to investment analytics and risk-management software as a criterion for separating qualified advisors from generalists that rely on the product manufacturers' inherently conflicted proprietary reporting system. Although software products to select and monitor investment products are not the only criteria a plan sponsor should use to select a qualified advisor, such criteria merits significant weight when determining which advisors should be considered.

> ***Observation:*** *Throwing a dart may produce the same results, but it is not a process that is acceptable under an ERISA prudent man standard. Successful investment advisors embrace automation as a means to establish a process that is acceptable, quantifiable and can be defended.*

More Fund Facts

Most Popular Bond Funds

Fund Name	Investment Category	Usage
American Funds American Hi Inc Tr	High Yield Bond	5-10%
PIMCO High Yield	High Yield Bond	0-5%
Vanguard High-Yield Corporate	High Yield Bond	0-5%
Bond Fund of America	Intermediate-Term Bond	10-15%
JPMorgan Core Bond Select	Intermediate-Term Bond	10-15%
PIMCO Total Return	Intermediate-Term Bond	50-55%
American Century Government Bond	Intermediate Government	10-15%
Wells Fargo Advantage Government Sec	Intermediate Government	5-10%
PIMCO Real Return	Inflation-Protected Bond	10-15%
Vanguard Inflation-Protected	Inflation-Protected Bond	0-5%
Loomis Sayles Bond	Multisector Bond	0-5%

Most Popular Stable Value Funds

Fund Name	Investment Category	Usage
Federated Capital Preservation Fund	Stable Value	5-10%
MetLife Stable Value	Stable Value	15-20%
Morley Stable Value	Stable Value	5-10%

Most Popular Money Market Funds

Fund Name	Investment Category	Usage
First American Prime Obligation Y	Money Market Taxable	5-10%
Schwab Investor Money	Money Market Taxable	15-20%

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SIMILAR BUT DIFFERENT

Based upon our analysis of the PlanTools™ database, with few exceptions, investment recommendations are more different than alike among the advisors using the PlanTools™ standards-based risk management system. Of course, the question is, "Why are client portfolios designed so differently by the same advisor or advisors using the same system?"

Although there may be more plausible views than those mentioned, we posit the following reasons for this phenomenon:

1. **Many Acceptable Options**: There are many acceptable investment alternatives for the same investment category using the same investment selection preferences;
2. **Investment Preferences**: A fiduciary's investment selection preferences are more different than alike; therefore, investments are uniquely tied to the specific objectives of each retirement plan;
3. **Advisor Enhanced Research**: Use of returns or holdings based regression analysis may affect the investment selection process and thereby affecting the usage of one investment over another;
4. **Product Manufacture Limitations**: Investments may be popular with some advisors and retirement plans due to product limitations that affect the number of available investments from which to choose;
5. **Compensation**: Fund selection could be affected by the compensation or revenue sharing provided by a particular investment option and thus affect the recommendation or usage of a particular investment option; or
6. **Timing**: All things considered, the investment selection process could be greatly influenced by the historic performance of all comparative investments at the time the menu is created.

Although all six propositions offer possible reasons why existing portfolios differ, my discussions with PlanTools™ users indicates the difference exists because PlanTools™ users adopt a process that is directly tied to the objectives of the plan sponsor.

FUND REVIEW CONCLUSIONS

Whether the reason is one of the above, a combination, or a reason other than those mentioned in this analysis, one fact is certain - retirement plans offer vastly different investment portfolios.

Observation: *Investment performance is often the impetus for litigation, but it is the failure to adopt a process that permits a plaintiff to prevail.*

Most Popular Small Cap Funds

Fund Name	Investment Category	Usage
Allianz NFJ Small Cap Value	Small Value	5-10%
Columbia Small Cap Value	Small Value	5-10%
Northern Small Cap Value	Small Value	5-10%
Baron Small Cap	Small Growth	15-20%
Buffalo Small Cap	Small Growth	5-10%
Dreyfus Small Cap Stock Index	Small Blend	10-15%
Keeley Small Cap Value	Small Blend	15-20%

More Fund Facts

Most Popular Large Cap Funds

Fund Name	Investment Category	Usage
American Beacon Large Cap Value	Large Value	20-25%
Columbia Value & Restructuring	Large Value	10-15%
Calamos Growth	Large Growth	15-20%
Domini Social Equity	Large Growth	10-15%
Growth Fund of America	Large Growth	70-75%
Jensen	Large Growth	10-15%
Davis NY Venture	Large Blend	25-30%
Fidelity Spartan U.S. Equity Index	Large Blend	10-15%
Fundamental Investors	Large Blend	10-15%
Schwab S&P 500 Index	Large Blend	20-25%
Schwab MarketTrack Growth	Large Blend	15-20%
Vanguard 500 Index	Large Blend	15-20%

Most Popular Mid Cap Funds

Fund Name	Investment Category	Usage
Goldman Sachs Mid Cap Value	Mid-Cap Value	15-20%
Perkins Mid Cap Value	Mid-Cap Value	5-10%
Columbia Acorn	Mid-Cap Growth	15-20%
JPMorgan Diversified Mid Cap Growth	Mid-Cap Growth	5-10%
Ariel	Mid-Cap Blend	10-15%
Dreyfus MidCap Index	Mid-Cap Blend	15-20%
Vanguard Mid Capitalization Index	Mid-Cap Blend	10-15%

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More Fund Facts

IS GOLF A COMPETITIVE ADVANTAGE?

Advisors continue their search for a competitive advantage in a market where business has historically been driven by social and personal relationships versus any technical expertise. Although it is not unreasonable for a fiduciary and advisor to share a close personal friendship or engage in other business activates such as banking, placement of health, property and casualty insurance or even enjoy a round of golf together, such activities are a problem when the relationship exists at the expense of the participants. The framers of ERISA issued sweeping revisions to pension law in 1974 with a no tolerance policy for conflicts of interest and self-dealing. This policy begs the question, "How much expertise is necessary to justify retaining a close personal friend as your advisor?"

This question is particularly challenging when our survey of product manufacturers and third party administrators inform us that 80% of the retirement plans they support are serviced by an advisor with five retirement plan clients or fewer. Although there are always exceptions, an advisor with five or fewer retirement plan clients is more likely to be a dilettante than an expert. In other words, in a life and death situation, would you hire a doctor to perform heart surgery on you if the doctor had only performed the procedure five or fewer times with no previous experience or training?

Granted, there are always exceptions, but based upon my research, there are over 75,000 advisors servicing five or fewer clients in one of the most complicated areas of law with little or no previous training or experience. Sadly, your car mechanic can become a state based Registered Investment Advisor easier than he or she can become a hair stylist. As one industry pundit quips, generalists are like blind squirrels and even a blind squirrel finds a nut every now and then.

Fiduciaries cannot justify paying an advisor for services based upon skills he or she doesn't possess. Instead, ERISA requires plan sponsors to hirer experts where that expertise does not exist or is lacking. If the advisor is not well equipped, experienced and current in his/her skills, then retaining the advisor is not a defensible prudent decision. Of course, until the creation of the ERISA Advisor Evaluator (EAE), there has been no solution available to assist a plan sponsor's search to identify and retain a qualified plan advisor.

***Observation**: Fiduciaries cannot justify paying an advisor for services based upon skills he or she doesn't possess, and they can never justify retaining certain relatives.*

Most Popular Target Fund Families

Fund Name	Investment Category	Usage
Schwab	Target	16.04%
Barclays	Target	9.84%
T. Rowe Price	Target	9.76%
Fidelity	Target	7.04%
Vanguard	Target	3.04%
AllianceBernstein	Target	1.84%
American Funds	Target	1.72%

Most Popular Sector Funds

Fund Name	Investment Category	Usage
BlackRock Health Sciences Ops Inv	Specialty Health	0-5%
T. Rowe Price Health Sciences	Specialty Health	0-5%
Schwab Health Care	Healthcare Sector	5-10%
Jennison Natural Resources	Specialty Natural Resources	0-5%
PIMCO Commodity Real Ret Strat	Specialty Natural Resources	0-5%
Oppenheimer Gold & Special Minerals	Specialty Precious Metals	0-5%
Cohen & Steers Realty	Specialty Real Estate	10-15%
First American Real Estate	Specialty Real Estate	0-5%
Third Avenue Real Estate Value	Global Real Estate	5-10%
Allianz RCM Technology	Specialty Technology	0-5%
Ivy Science & Technology	Specialty Technology	0-5%
MFS Utilities	Specialty Utilities	0-5%

NOTE:

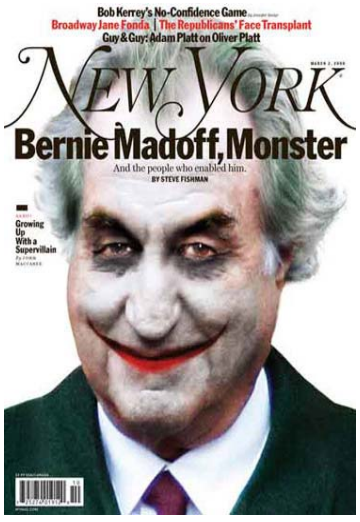
1. Category Style is provided by Morningstar
2. The Usage is the percentage of plans on the PlanTools system that offer that investment.
3. Sort is by Investment Category and the secondary sort is alphabetized by fund name.
4. All share classes of an investment option were combined to determine the market penetration under the Usage column.
5. Although PlanTools does provide analytics capabilities for wealth management clients, all the above statistics are tied to retirement plans.
6. The statistics are based upon the use of registered investment companies. Group Annuity separate accounts were excluded from this analysis.

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WHEN THINGS GO WRONG

When things don't go as planned, who do you want on your team to navigate the complicated waters of ERISA, a part-time generalist or a full-time expert? Consider the turmoil that plan sponsors have faced over the last ten years:



1. Late day trading and market timing of mutual funds,
2. Large and small vendors leaving the marketplace, many after blowing up,
3. Undisclosed revenue sharing,
4. Excess fee litigation,
5. Target date strategies and products under Federal investigation,
6. The economy and plan investments tank,
7. The product or service platform blows up,
8. Participant behaviors change,
9. Fraud, embezzlement and misrepresentation (Bernie Madoff), and
10. Multiple changes to pension law.

Should we expect anything less over the next ten years? If the next ten years is a repeat of the past ten years, "can you justify doing business with a part-time generalist versus retaining a full-time ERISA expert?"

Generalists derive a small portion of their gross revenues from retirement plan clients which provides little incentive to build the necessary knowledge and experience to support expert status. Most generalists are commissioned advisors that operate according to the traditional suitability standard with no ability to operate as a fiduciary. Commissioned advisors make the argument that on-going commission payments are just an amortization of the upfront cost to sell a plan but that argument offers little solace if the plan sponsor cannot tie the continuous payment of commissions to necessary services.

Unlike generalists, a qualified advisor builds a successful ERISA advisory practice on their extensive experience, technology resources, and intellectual capital. Their compensation is derived from delivering specified services outlined in their service agreement and not by commissions derived from a relationship sale. Their experience and dedication to increasing their intellectual capital enables them to navigate difficult market conditions on behalf of their clients to minimize the risk of large losses and litigation.

***Observation**: If an advisor will not accept fiduciary liability for their actions and if the advisor does not have Errors & Omissions Insurance to cover fiduciary breaches, the plan sponsor and their fiduciaries become the deep pockets for monetary damages.*

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NEW SOLUTIONS - *e*Harmony MEETS ERISA

Choosing an advisor is more difficult than choosing investments. At least with investments there are multiple software packages available to assist experts in identifying prudent investments. There is no such support for selecting an advisor until now. Under the direction of Phil Chiricotti, President of the Center for Due Diligence (CFDD), a plan sponsor will have access to the first independent and objective Request For Proposal (RFP) system designed to provide a plan sponsor a prudent and documented selection process for retaining a qualified advisor.

Only advisors that have met minimum qualification standards will be permitted to participate in the ERISA Advisor Evaluator (EAE) directory. The EAE directory will provide a plan sponsor with a logical and educated process to evaluate, select and monitor qualified advisors. This will permit a plan sponsor to make a knowledgeable decision removed of any emotional ties that might conflict with the best interests of the participants. As a result, plan fiduciaries will no longer be subjected to making advisor decisions based on the heart instead of the intellect.

Specialized knowledge and experience are key indicators when selecting a qualified advisor but plan sponsors have historically been without a methodology to objectively assess an advisors qualifications and capability, hence, the reason so many dilettantes have been retained to service retirement plans. EAE will eliminate this problem, consolidate the industry into the hands of those capable qualified advisors and reduce plan sponsor risk.

Better, faster, smarter and more profitable professional relationships are the result. If your advisor is not in the EAE directory, he or she may not be qualified to provide services to your plan.

PlanTools™ developed the first automated, standards-based analytics and reporting system in the industry (2001). The system has since evolved into an integrated, web-based expense analysis, benchmarking and fiduciary governance solution. No other company has combined as many metrics under one solution as PlanTools™ and with thousands of plans supported by expert PlanTools™ users - effectively, efficiently, and ethically, PlanTools™ will remain the preferred solution for expert advisors.



Even a blind squirrel gets a nut every now and then.

But would you want to defend your decision to hire a blind squirrel servicing your retirement plan?

DON'T BE A BLIND SQUIRREL

For more information on our research or the FRA / PlanTools solutions, contact David J Witz, AIF® Managing Director at 704-564-0482 or dwitz@fraplantools.com.

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