

Now and Then

Fidelity looks ahead to dominate retirement planning now

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When it comes to plowing through the complexities that are associated with retirement planning, advisors need all the help they can get. Not only do they face increasing demands from pre-retiree and retiree clients for a broader range of products and services, but advisors also have more products and services—and regulations—to sift through these days. Confounding the challenge even more is the fact that industry executives continually remind advisors that to be successful at retirement planning, they have to change their mindsets—and, in most cases, their business models. How is an advisor to cope?

Advisors are increasingly finding that their custodian is one of the best resources to turn to. Indeed, Fidelity Investments is pulling out all of the stops to make sure it's providing all of the retirement planning tools and services advisors need to meet their challenges head-on—all while helping the Boston-based brokerage and mutual fund company to grab the lion's share of the booming retirement market. In fact, Ellyn McColgan, president of Fidelity Brokerage Company, has stated publicly that tackling retirement issues is her top priority. McColgan even directs the executives within the three major divisions she oversees—Fidelity Registered Investment Advisor Group (FRIAG), National Financial, and Fidelity Personal Investments—to zero in on retirement.

“Retirement is the No. 1 focus for Fidelity across all of our [distribution] channels,” says Sandy Metraux, executive VP at National Financial, Fidelity's clearing arm that offers services to broker/dealers who represent approximately 70,000 brokers. Metraux also notes that Bob Reynolds, vice chairman and COO of Fidelity Investments, pushes the retirement card just as hard as McColgan. Fidelity believes that “retirement is one of the biggest—if not the biggest—opportunities for advice givers today,” adds Gary Gallagher, a senior VP at FRIAG.

Good for Advisors; Crucial to Fidelity

Offering retirement services is not only crucial for advisors' practices, but it's critical for Fidelity's success as well. Fidelity is “committed” to helping advisors and brokers navigate the complex world of retirement planning, Metraux says, because it's “important for [Fidelity's] success, and it's very important from a marketplace perspective.” Taken together, the three divisions that provide services to advisors and brokers—National Financial, FRIAG, and Fidelity Investments Institutional Services (FIIS)—represent \$1 trillion in assets under administration. That's larger than Fidelity's retail business, which counts \$700 billion in assets under administration. National Financial represents more than \$600 billion in assets, while FRIAG, which provides wealth management, custody, and brokerage services to financial intermediaries, custodied \$218 billion in assets on behalf of 3,100 RIAs and 170 bank trust and TPA firms as of August 31. FIIS, which provides product solutions to RIAs and brokers, had total assets under management of more than \$231 billion as of August 31.

Citing internal data generated by Fidelity, Metraux says the retirement marketplace holds about \$25 trillion in investable assets, and that 40% of those funds are controlled by RIAs, broker/dealers, or bank trust companies. Those numbers show that it's not only crucial “to serve the advisors, but that they are hungry for the value-added services that [Fidelity] provides,” she says.

Collaboration and Education

How does Fidelity go about providing a broad array of retirement services and products to satisfy such a huge and diverse universe of advisors and brokers? The key is collaboration among all three of Fidelity's advisor/broker divisions—FRIAG, FIIS, and National Financial. “We're very conscious of how we leverage each other and work

together, particularly on the retirement front,” says Gallagher. The “issues around retirement are getting more and more complicated, and individuals are turning to advisors,” adds Metraux. “What we need to do for the advisor is make [retirement planning] simpler for them.” Fidelity focuses on “making [the services] integrated and part of [advisors’] ongoing process so they can extend what they’re doing today as opposed to starting all over.” All three Fidelity divisions collaborate to help advisors in three areas: education, products and services, and integrated technology to support firms within each division. When addressing retirement planning issues, Gallagher says Fidelity educates advisors about “how they need to prepare themselves for changes in their businesses, and how they can be successful” doing so. For instance, in late September, Fidelity launched the Fidelity Research Institute, a think-tank made up of senior Fidelity employees that seeks to unravel important challenges—like retirement and healthcare—being faced by individuals as well as intermediaries. The research institute is “meant to benefit all of our channels,” says Metraux, noting that a recent topic that the institute addressed was on finding the most tax efficient method to withdraw assets at retirement.

Outside of the institute, Gallagher says the divisions have been developing white papers and holding educational seminars for advisors about what the Pension Protection Act means for their businesses. Dave Liebrock, an executive VP with Fidelity Institutional, along with a colleague in Fidelity’s government relations department recently conducted a conference call with advisors and brokers to discuss the Pension Act’s nuances and the opportunities it presents. “We had more than 1,800 advisors dial into that conversation,” Liebrock says. Advisors can also log on to fidelityadvisor.com and get a summary of the Act. In laying out the opportunities for advisors now that the pension reform bill is law, Liebrock said he noted the fact that the Act makes permanent the Economic Growth and Tax Relief Reconciliation Act of 2001’s increases in IRA and 401(k) plan contribution limits, catch-up provisions under 401(k)s, as well as tax incentives under 529 plans. If advisors had “clients who were on the fence with those changes—because originally they were going to sunset in 2010—now they are permanent, [and] that presents opportunities for advisors to go out and talk to people,” Liebrock says.

This year, Liebrock points out that Fidelity launched an automatic increase program that allows 401(k) plan participants to elect to automatically increase their deferral amount by 1%, 2%, or 3% each year. Other topics included “what auto enrollment means to advisors’ businesses,” and whether advisors should encourage plan sponsors to include auto-enrollment, as well as the advice provision of the Act. Liebrock notes that there are still some “technical corrections” to come out in relationship to the advice provision. There are questions about the portion of the act that states “in the case of an advisor giving advice from a fiduciary standpoint, they have to receive ‘level compensation,’” he says. What the term “level compensation” means exactly hasn’t been spelled out.

So how many Fidelity advisors are actually servicing and selling retirement plans? “We have over 50,000 advisors that we do business with today in the institutional services company, and we’re dealing with about 3,000 advisors that are selling a 401(k) of some sort,” Liebrock says. The number is growing, however, he says.

Another educational initiative at Fidelity involves conducting seminars around retirement income planning. To prepare advisory firms in helping their clients prepare for retirement, Fidelity execs tick off what Fidelity sees as the five biggest risks to consider when prepping for retirement. First is longevity, which is the risk of outliving one’s savings. Fidelity says there’s a 50% chance that at least one member of a 65-year-old couple will live to age 92. Second is the excessive withdrawal rate. Fidelity warns advisors that a withdrawal rate of more than 4% increases the chance that a client will run out of money too soon. The third risk is inflation—as inflation pushes prices up, the buying power of the dollar plummets, so it’s crucial for clients’ investments to outpace inflation. The fourth risk is asset allocation, meaning that not having the right mix of equities and bonds in a client’s portfolio can affect the portfolio’s long-term growth potential, increasing the chance that a client could outlive her money. The fifth risk is escalating healthcare costs. Fidelity estimates that a 65-year-old couple retiring today will need \$200,000 to cover medical costs in retirement. National Financial’s Metraux says that helping clients with healthcare issues “will be a spotlight for us in the future.”

Products and Services

The next area that Fidelity focuses on in helping advisors is providing a suite of comprehensive products. The advent of retirement income planning “is creating a new category of product innovation,” FRIAG’s Gallagher says. Fidelity has “a comprehensive retirement product set that’s available to all of our channels—like individual, and small-business products, IRAs, rollovers—you name it, we have it.” For instance, FIIS—which provides investment management services through advisors at wirehouses, regional and independent broker/dealers, banks, trust

companies, and insurance companies—offers the Fidelity Advisor 401(k), a fully integrated investment management administration, custodial, recordkeeping service for advisors to sell to their clients, plan sponsors, and participants. The Advisor 401(k) offers both Fidelity and non-Fidelity funds. Recently, Fidelity raised the number of outside funds advisors can select from for their 401(k) plans to 850, Liebrock notes.

Stace Hilbrant, a planner with 401(k) Advisors LLC in Northfield, Illinois, says that when comparing custodians, Fidelity's investment options stand out. "Fidelity does a nice job of offering investment choices—all the investment style boxes that you might need for those who want to select investments on an individual basis." He also likes Fidelity's prepackaged options, like the lifecycle or lifestyle funds offered through Fidelity's Freedom Funds, which are often used as default options in 401(k) plans (though there are issues with such funds—see *The Benefits and Drawbacks of Auto-Enrollment* on page 52).

Fidelity offers both retail and advisor versions of the Freedom Funds, and the advisor funds are growing much faster than the retail version. "The Freedom Funds are very upfront about how they create their [lifestyle fund] models, the allocations utilized by each one of the models, and the promotional materials that go along with them to explain to participants their value," Hilbrant says. "The materials have to be employee-friendly. Fidelity's [Freedom Funds] are very user friendly to the advisor channel because advisors first need to understand what's in the model."

FIIS also recently launched a program called Retirement Plan Review, which helps advisors sell and service more retirement plans. The program gathers "all of the data of a particular plan and boils it down for the advisor to help them pinpoint where they should be spending their time," Liebrock explains. For instance, the program "looks at participation deferrals, asset allocation by age group, and then also benchmarks that against companies of similar size in the same industry. So instead of the advisor having to put all this data together to have a conversation with the plan sponsor, Fidelity puts it together so the advisor is spending 90% of their time talking with the plan sponsor about solutions, instead of 90% of their time trying to get the data together."

Advisors can enlist the aid of Fidelity's Retirement Education Consultants—Series 7-licensed individuals who assist advisors with enrollment and diversification meetings. If an advisor can't get to all of the different plan sponsor locations, the consultants can fill in for advisors and conduct the meetings. The consultants' "only role is to support advisors from an educational standpoint for participant meetings," Liebrock says. Fidelity now has six of these consultants spread across the country and is looking to add more.

Fidelity's First Person Communication program was launched a year ago, and is designed to send out personalized messages to plan participants encouraging them to either enroll in a plan or start deferring more. "Historically, communication and education to participants in a 401(k) plan was very broad-based," Liebrock says. "It wasn't personalized and most people said, 'It doesn't pertain to me,' and threw it away." Fidelity "did a lot of research and found that the more personalized the message, the better the chance the person will react to it." So it did. For instance, for those participants who aren't deferring up to the company match, we send them a notice addressed to them saying, 'Did you know you could be deferring more and taking advantage of your company's match?'" Fidelity found that with the personalized communications, "deferrals increase significantly and diversification changes, and people enroll," he says. The program also helps advisors, who have limited time, "to get more people into the plan, increase deferrals and diversify assets."

Something Special for RIAs

On the RIA side, Gallagher of FRIAG cites the Fidelity Retirement Network, which matches advisors with independent third-party administrators across the country that help advisor and brokers deliver retirement solutions. "We have a very strong channel of third-party administrators which are independent TPAs who also provide services in the smaller plan market," he says. The service was just what Harold Evensky, the well-known planner with Evenksy & Katz in Coral Gables, Florida, needed when his eyes opened to what he saw as a "great opportunity in the 401(k) market," with his firm now serving as the fiduciary advisor to the trustees of 401(k) plans.

Evensky—who recently edited a book with his wife, Deena Katz, about retirement distribution planning (*Retirement Income Redesigned*; Bloomberg, 2006)—was able to interview a group of TPAs that Fidelity had recommended, and finally chose The Newport Group in Charlotte, North Carolina. "We've developed an immensely competitive offering to do a series of 401(k) plans working with Newport with Fidelity as the custodian," Evensky says. "We're extremely happy with that because Fidelity provides us access to practically any fund we could want in the

institutional series—such as the PIMCO funds, DFA Funds, or the retirement series of the American Funds—at extraordinarily low custodial cost.”

Gallagher says Fidelity has noticed that among advisors who work with high-net-worth folks, wealth management products—particularly trust services—are becoming more and more important. That’s why Fidelity has “spent a lot of time building out our trustee service offerings that offers the ability to provide integrated trust and brokerage services,” he says. “If you look at why high-net-worth folks establish trusts, close to 25% of the reason is retirement related.” (See sidebar “Of TPAs and Trusts”.)

Technology Tools

The last, but certainly not the least important, piece of Fidelity’s service package for advisors is technology.

Fidelity is now building for advisors what it believes “is the next generation of retirement income planning tools,” says Gallagher. The retirement income planning tool will be “integrated with advisors’ operations and how they behave with clients—so we’ve spent a lot of time bringing these tools into the various platforms that our channels support.” For example, Fidelity will be introducing next year for the RIA channel a retirement income planning tool that will be completely integrated with its Advisor Channel RIA platform, he says. The platform will also be fully integrated with National Financial’s front-end platform for advisors and brokers, called Streetscape. “It’s important to not only provide tools, but to provide it in a perspective that operates the way [advisors and brokers] manage the client assets on a day-to-day basis,” adds Metraux of National Financial.

Gallagher adds that Fidelity’s technology is designed to accommodate the needs of advisors’ and brokers’ differing practices. “We’ve built the platforms to be flexible and address the nuances of the delivery channels,” he says. “We understand that not every practice model operates the same way.” Plus, adds Metraux, from a regulatory environment, “the checks and balances that are required in being an RIA versus a B/D are built into each of our systems.”

There’s no doubt that retirement planning has become increasingly important not only to advisors’ continued success, but to their custodians’ success as well. The changing demographics of the American population, the coming tidal wave of retiring Baby Boomers, and the massive intergenerational wealth transfer that will occur over the next decades will force more advisors to sharpen their retirement planning skills—and custodians must be prepared to help them. While Metraux admits that taken separately, each of Fidelity’s retirement planning services may not outrank those services provided by other custodians, but in aggregate, she says, “if you look at the full range of [Fidelity’s services], the thought leadership, technology, and support, we’re confident we’re ahead of the competition.”

The Benefits and Drawbacks of Auto-Enrollment

Lifecycle funds are not a panacea

Among the many provisions of the recently enacted Pension Protection Act (PPA) of 2006 is one that permits retirement plan sponsors to create automatic enrollment programs for their 401(k) plans. This should help an already booming investing vehicle—lifecycle or lifestyle funds—attract more funds from participants who choose a lifecycle fund from a 401(k) menu and as the default investing option under auto-enrollment. How popular are lifecycle funds? According to the Investment Company Institute, net inflows to these funds more than doubled in 2005 to \$49 billion, accounting for nearly 20% of all new net inflows to U.S. mutual funds.

Manning and Napier, a pioneer in the formation of lifecycle funds, cautions that participants and consultants to plan sponsors should conduct their standard due diligence when it comes to picking a lifecycle fund as either the default option under an auto-enrollment scheme or for any other investing purpose. Defaulting plan participants into lifecycle funds are important for those participants who are not looking to make their own asset allocation decisions, says Kristen Castner, a managing director at the Rochester, New York-based company, which manages about \$12.5 billion in separate accounts, collective trusts, and mutual funds for high-net-worth individuals and institutions, using what it calls an objectives-based multi-asset class management approach similar to a lifecycle fund. “But when you

get a lifecycle fund in a plan,” she says, “you want to make sure it’s an actively managed investment approach so there is protection in a down market.”

Commenting on the PPA’s provisions, she agrees that “Auto-enrollment is a huge positive,” for plan participants and for plan sponsors, and the ability of plan sponsors to use lifecycle or balanced funds as the default investing option as opposed to money market or stable income provides some “relief” from the fiduciary responsibility of selecting funds. “Stable income or money market [funds] might be good in a rough [market] time,” Castner argues, “but it’s not the kind of vehicle that will give plan participants the most bang for their buck over a variety of environments.” If, however, “there’s a default fund tied to your current age and your planned retirement age—that’s one of the best ways to get participants to default.” Castner expects the popularity of retirement target date funds to continue to grow, driven by auto-enrollment and the use of such funds as a default option. But she points out that about 70% of the lifecycle funds in the Morningstar universe are risk-based: “They don’t have that target retirement date tied to them. Instead, they’re labeled as conservative or aggressive or moderate, so the participant would choose based on their personal circumstances.” She counsels plan sponsors that the process of selecting a lifecycle fund family “should be no different than selecting a small-cap fund for the menu,” suggesting that retirement target date funds might fit better with certain participant demographics, such as a blue-collar workforce, while risk-based funds might make more sense for professionals.

Also, since so many of the lifecycle funds—85% of them in that Morningstar universe, she says—are funds of funds with an average of 3,000 holdings, “you start to question how you can actively manage that many holdings; it’s more like an index.”—**James J. Green**

Don’t Spend It Early

A necessary part of retirement planning involves devising a spending plan that is flexible enough to balance lifestyle desires and life changes with available financial resources. While spending for many retirees declines from the early years when people are more active, spending too much in those early years could cause irretrievable harm, warns Steve Doucette, a CFP who is VP of Proctor Financial of Wellesley, Massachusetts. He argues that advisors should design specialized allocation plans for retiring clients and help clients stick with the original plan. “If they have a proper allocation, they should be able to spend what they need to,” he says. The danger, he says, is that with overspending, a portfolio that should continue to grow through retirement instead gets sent on “a downward slide,” that’s difficult to reverse without going back to work or making lifestyle changes. Spending too much money in early retirement could be a “double whammy” if the market were to head south while the spending increase is going on, he adds.

“Cash can always be made available by selling assets,” notes Doucette. However, having the right amount of liquid assets at each stage of retirement ensures that a client does not have to sell equities in a down market, he adds.

In addition to helping retired clients not run out of money, having a proper plan provides emotional benefits as well, Doucette points out. Merrill Lynch’s The New Retirement Survey, released in early 2005, supports his claim. The survey found that while baby boomers recognize the growing uncertainty of government entitlements, those who have a retirement plan and feel prepared for their golden years are twice as optimistic about entering retirement as are those without a plan.—**Kara P. Stapleton**

Of TPAs and Trusts

In August, Fidelity inked a deal with SunGard to integrate the brokerage services of Fidelity’s Registered Investment Advisor Group (FRIAG) with SunGard’s trade order management technology. “The ultimate beneficiaries [of the deal] are trust companies and TPAs looking to avail themselves of [Fidelity’s] brokerage capabilities,” says Gary

Gallagher, a senior VP at FRIAG. The core of most TPAs' business models is providing such retirement services as plan administration and advisory services. Fidelity "is now servicing a much bigger universe of TPAs."

Among wealth managers who deal with high-net-worth clients, providing trust services is becoming a crucial aspect of retirement planning because "trusts are the vehicle for providing intergenerational transfers of wealth," Gallagher says. About 25% of the reason why people establish trusts has a retirement component to it, he says. "Trusts are created to provide control [of a client's money], but also to minimize taxes," he explains. "Trusts are set up to provide current income, and protect [clients'] assets so that they can gift assets away—through a charitable remainder trust."

Plus, he points out, "retirement isn't just about accumulating and then spending down after you've earned it—it's equally about how to manage wealth in retirement." It's difficult to separate trusts and retirement, "because you're looking at planning for heirs, how you're moving assets around, and intergenerational wealth transfer." For advisors, Fidelity provides "enhanced reporting that they can provide to clients as well as trustee services," he says, and also provides "an integrated brokerage trust environment so that advisors can manage trust assets and brokerage assets in one single view." That's primarily available through the RIA business, Gallagher admits, but says the company is expanding its offerings through its clearing firm for B/Ds, National Financial.—**M.W.**

Carey Out, Callahan In at FRIAG

FRIAG, the Fidelity unit that serves RIAs, will have a new chief for the second time in only 15 months. Jack Callahan, a 15-year Fidelity veteran, will succeed Bill Carey as president of FRIAG effective November 1. Callahan was most recently president of Fidelity Institutional Retirement Services Company—the same post Carey had held prior to his appointment at FRIAG.

Carey in turn will become executive VP of national accounts at Fidelity Investments Institutional Services Company. Highlights of Carey's tenure at FRIAG include "developing a market segmentation strategy, a renewed focus on measuring and improving customer satisfaction, and the recently announced partnership between SunGard and Fidelity," says Fidelity spokesman Stephen Austin.—**Kathleen M. McBride**



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