Large Bank Retirement Services:
A Comparative Practices Study

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Executive Summary

Introduction

This report analyzes information examiners gathered in the second half of 1998 from large national banks that offer retirement services. The information provides insight on these banks' strategic plans for retirement services, the banks' assessment of the risks associated with retirement services, their risk management processes, and how banks operate their 401(k) retirement services.

The OCC initiated the retirement services project in order to increase the agency's knowledge of current practices in the retirement services industry and the role national banks play in this market. Because of dramatic changes in the industry following the introduction of 401(k) plans, the OCC also identified retirement services as an area of potential risk to national banks. The OCC designed the project to help identify areas of potential risk and gauge banks' current risk-management processes.

Overall, the large national banks in our study seem to be aware of and managing the many risks that can arise in retirement services. They have risk management programs in place and actual losses because of problems in retirement services have been small. Results also suggest that the banks are mindful of new challenges that might arise because of rapid changes in the retirement services industry. While most large banks in the study consider their reputation, strategic, compliance, and transaction risks to be modest and stable, roughly a fourth believe their strategic, compliance, pricing, and transactions risks are increasing. The banks suggest that risks are increasing because of greater demands for service, increasing expectations for technological capabilities, and greater competition.

The project also answered the following questions:

- How is the retirement services industry changing?
- Who are the major industry players that compete with national banks?
- What are large national banks doing to meet the challenges of the changing industry?

Highlights

The following are some of the more significant insights from the study.

- **The Retirement Services Market –** At the end of 1998, retirement assets totaled $10.8 trillion. Private pension fund assets, which account for $4.4 trillion of this total, are evenly split between the two principal types of employer-sponsored retirement plans: defined contribution plans and defined benefit plans. In a defined contribution plan, employer and employee contributions to the plan and the performance of the employee's chosen portfolio will determine an employee's retirement income. The popular 401(k) plan is an example of a defined contribution plan. Alternatively, in a defined benefit plan, an employer agrees to pay a fixed retirement benefit that usually depends on the employee's salary during his or her last years of service and the employee's overall job tenure.

- **A Changing Market –** Defined benefit plans are gradually losing market share to defined contribution plans. Defined benefit plans held more than 70 percent of private pension fund assets in 1982 compared with 49 percent at the end of 1998. Defined contribution plans have seen a corresponding increase in market share from less than 30 percent to 51 percent. Industry observers expect the market share of defined contribution plans to continue to increase.

- **Competition –** Banks are not the dominant providers in the defined contribution market. In 1997, mutual fund groups had a 42 percent market share, insurance companies had about 22 percent of the market, and banks had 21 percent. Consistent with these figures, more banks in the study identified mutual fund complexes as a primary competitor than any other type of firm. Almost all of these banks also ranked mutual fund complexes as their strongest competitors. Many banks also identified insurance companies, brokerage firms, and other banks as major competitors.

- **Different Roles for Banks in the Retirement Services Market –** Banks in the study offer a wide array of retirement products and services. Banks have the option of using outside providers for many of these products and services. Banks can act as both administrator and investment manager through proprietary investment funds or they can act only as administrator by allowing investments with outside fund managers. Banks can also outsource many of the administrative and record keeping services of the retirement plans they offer.

- **Banks' Competitive Advantages and Disadvantages –** As part of the study, banks identified areas in which they believe they have a competitive advantage and areas where they believe they are at a disadvantage. The advantages banks identified most often were superior customer service, customer relationship building, investment management services, bank reputation, bank distribution channels, and cross selling related financial services. The disadvantages or barriers the banks identified most often were processing capabilities, staffing and training issues, and regulatory burden.

- **Banks' Weaknesses in the 401(k) Market –** Examiners asked whether banks had identified any weaknesses in their 401(k) services. The shortcomings mentioned most often were in advanced technology, brokerage account links, financial planning services, automated processes, and record keeping systems.

- **Overcoming Disadvantages and Bridging Gaps –** Banks identified several ways in which they plan to expand services and bridge address shortcomings. Many of the banks intend to use a combination of approaches by either outsourcing some services, building capabilities internally, forming partnerships, or acquiring third-party providers. Most of the banks studied intend to either introduce or expand the following services: internet inquiry and transaction capabilities, paperless loans and distributions, automated processing of self-directed brokerage accounts, voice response and client service representatives, and education and communications materials for plan participants.

- **Risks –** Banks must manage a variety of risks as they compete in the dynamic retirement services market. The study asked banks to identify the risks that they associate with retirement services. The risks most often identified were compliance/regulatory risk, competition/pricing risk, transactions/operations risk, fiduciary risk, and risks associated with technological change. Strategic risk, staffing, reputation risk, and market risk also appeared in the responses, although not as often.

- **Risk Management –** Banks participating in the study appear to be aware of the many risks they face and all have a risk management process in place. Overall, the majority of these banks currently see retirement service risks as modest and stable. Nonetheless, some banks clearly believe that certain risks are increasing. These two views of risk may reflect how the shift from defined benefit to defined contribution retirement plans has brought dramatic change to the traditional operating model for some national bank providers of retirement services.

- **Fees –** Government regulators, employers, plan participants, and the financial press are focusing greater attention on fees providers charge defined contribution plans and the plans' participants. Our study found that, like other retirement services providers, large national banks charge widely varying fees and have complex fee structures for retirement services. The complexity of the fee structure makes it difficult to compare fees across providers, and thus makes it difficult for employers to find low-cost providers.

Conclusion

Increasing demands for state-of-the-art technology, strong competition, and narrowing profit margins create a challenging environment for banks. The cumulative impact of these changes may be an increase in the overall risk profile for some of the national banks that choose to compete in this growing and complex line of business. Competition and increasing complexity place greater demands on both the technological capabilities of retirement service providers and the risk management skills of those responsible for running retirement operations.

I. Introduction

The retirement services market exploded from $1.6 trillion in 1983 to $10.8 trillion dollars by year-end 1998, an average annual growth rate of 12 percent.[1] Banks, mutual fund companies, pension funds, insurance companies, and brokerage firms manage most of these retirement assets. In recent years, however, the role and importance of each of these intermediaries has changed dramatically. The most critical influence has been the recent ascendance of defined contribution plans over defined benefit plans.[2] To provide perspective on the growing importance of defined contribution plans and the role of national banks in this expansion, the OCC studied 23 large national banks that provide retirement services.[3] Although large national banks were the focus of the study, smaller institutions may find information in the study useful even if they do not offer retirement services.

This report investigates the level of bank activity in the retirement services market, national bank commitment to the market, and the market's profitability and fee structure. The study also examines what the large national banks in the industry perceive as their greatest challenges and risks.

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[1] Current dollars. Retirement assets are the sum of Individual Retirement Accounts (IRAs) and pension fund reserves. Source: Board of Governors of the Federal Reserve (1998: Release Z.1, p. 99; Flow of Fund Accounts 1982-90, p. 89), Investment Company Institute (1999), and U.S. Department of Commerce (1990, p. 598).

[2] A defined contribution plan links an employee's retirement income to the level of employee contributions and to the performance of the portfolio chosen by the employee. Alternatively, in a defined benefit plan, an employer agrees to pay a fixed retirement benefit that usually depends on the employee's salary during his or her last years of service and the overall tenure of service.

[3] The OCC conducted the study in the second half of 1998. Banks included in the study had to be in the OCC's large bank program and provide retirement services. Of the 26 possible participants, 23 banks participated, representing a response rate of 88 percent.

The retirement services market is highly competitive. Only four banks or bank affiliates are currently among the top 20 providers of defined contribution plans in the United States.[4] Of the top 23 national banks active in this area, only two national banks or national bank affiliates are among the top 20 providers. In contrast, eight banks or bank affiliates are among the top 20 defined benefit managers.

Most study participants expect the retirement services market to experience continued growth over the next three to five years. This is especially true for the 401(k) market, where 87 percent of study participants (20 of 23 banks) expect to expand their 401(k) products in the next three to five years.[5] Nonetheless, some banks have exited the 401(k) market entirely because of tightening profit margins.

Bank examiners gathered information about risks in the retirement services market, fees, and competitive advantages and disadvantages. Study participants most often cited superior customer service as an advantage and processing systems as a barrier. Participants also specified several services they expect to enhance. These services include Internet access for balance inquiries and transactions, self-directed brokerage accounts, and investment advice. The study also shows that many national banks have outsourced at least part of their 401(k) operations, most often participant record keeping services. Finally, the study finds a wide range in the fees for retirement services and how national banks structure their fees.

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[4] Similar changes have occurred in IRAs. In 1990, banks and thrifts controlled 42 percent of these assets, while by 1997 their market share was only 13 percent (Investment Company Institute, 1998a, p. 3).

[5] A recent study by Cerulli Associates suggests that the 401(k) business has grown for some banks. The study reports that banks' share of the 401(k) market increased from 17 percent in 1994 to 18.5 percent in 1997. The report indicates that Bankers Trust and State Street Global Advisors account for almost all of the increase. *See* Waddell (1998). Bankers Trust, State Street, Barclays Global Investors, and Dreyfus are the four banks or bank affiliates among the top 20 defined contribution providers in 1996 and 1997 (Cerulli Associates, 1999, p. 25).

The organization of the remainder of this study is as follows. Section II provides an overview of the retirement services market, emphasizing the 401(k) market and the role of national banks. Section III analyzes bank responses to questions regarding retirement services. The issues addressed in this section include the level of bank activity in the retirement services market, their commitment to the market, its profitability, and what the bank players in the industry perceive as their greatest challenges for continued success. Section IV summarizes results, provides conclusions, and discusses other potential areas of future research.

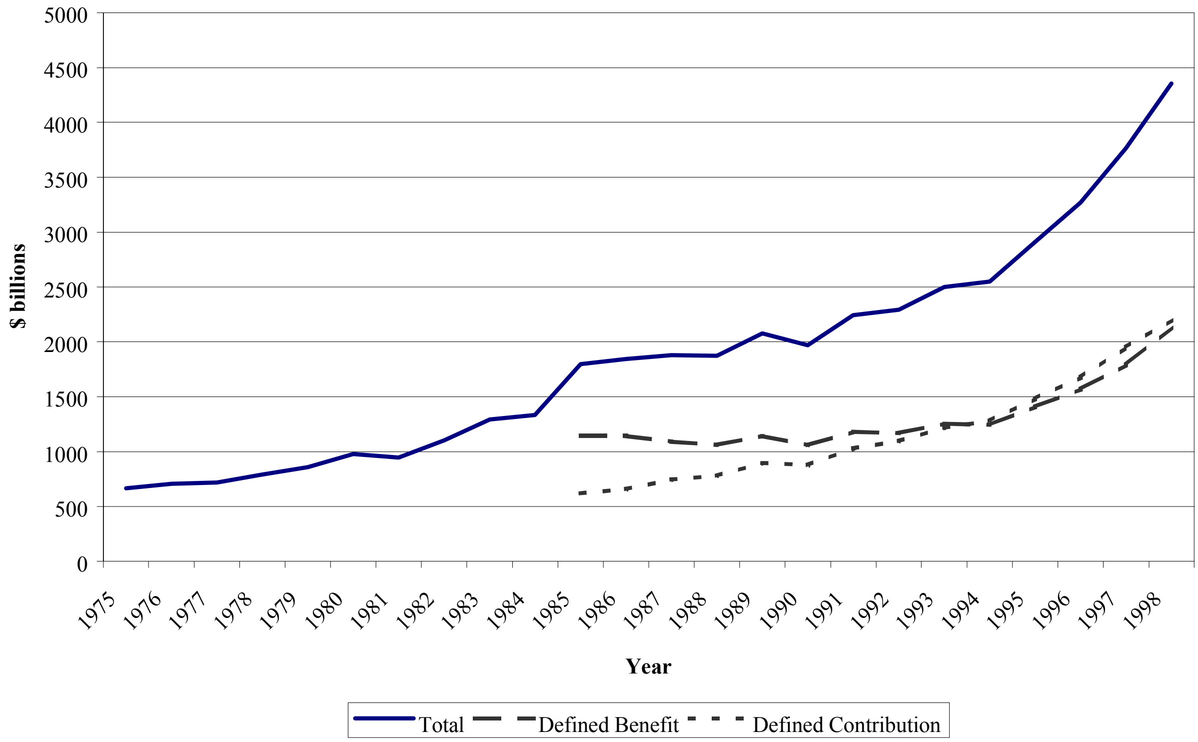
II. Industry Overview

The retirement services market has experienced tremendous growth over the past several decades. In inflation-adjusted dollars, the retirement services industry had a mere $150 billion in 1950 compared with $2.5 trillion in 1983 and more than $10.8 trillion today.[6] Pension fund reserves held by private pension funds increased from $44 billion in 1950 to $1.3 trillion in 1983, and to almost $4.4 trillion by the end of 1998. Figure 1 shows the inflation-adjusted growth of private pension funds between 1975 and 1998.

The number of workers covered by retirement plans has also increased dramatically over this period. In 1950, private pension plans covered only 9.8 million workers, or 25 percent of

[6] Retirement assets are the sum of Individual Retirement Accounts and pension fund reserves. Private pension funds, life insurance companies, the federal government, and state and local government retirement funds hold pension fund reserves. *See* footnote 1 and Board of Governors of the Federal Reserve (Flow of Funds Accounts 1945-53, p. 89). Dollar figures are 1998 dollars, adjusted by the GDP deflator. In nominal dollars, the industry had $24 billion in 1950, $1.6 trillion in 1983, and over $10.8 trillion in 1998.

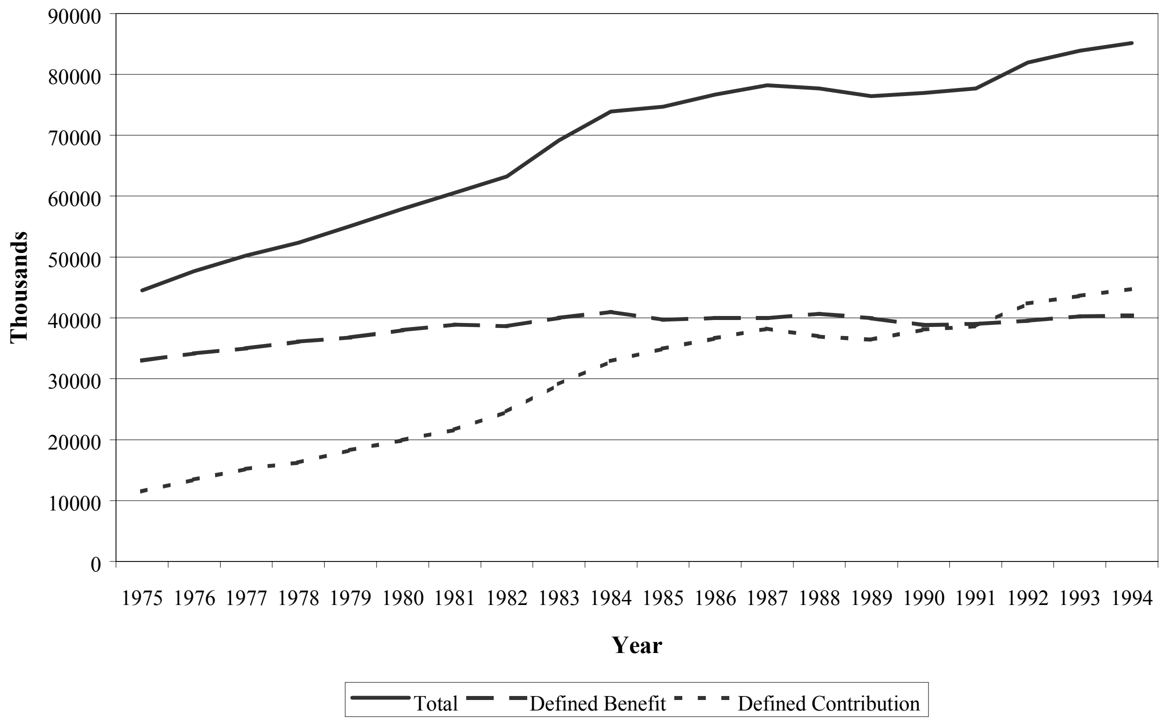
Figure 1. Real Private Pension Fund Financial Assets



private wage and salary workers. By 1983, private pension plans covered 39 million workers, or 46 percent of private workers. As of 1994, these plans covered 45 million workers (45 percent of private workers), 9 million retirees, and another 30 million workers either separated with vested rights to benefits or active and less than fully vested.[7] Figure 2 shows the total number of pension plan participants between 1975 and 1998 and the number of participants covered by defined benefit and defined contribution plans.

[7] Beller and Lawrence (1992, p. 75) and U.S. Department of Labor (1998, pp. 6 and 66).

Figure 2. Pension Plan Participants



Historically, life insurance companies and private pension funds managed roughly equal amounts of pension fund reserves, which they invested primarily in credit market instruments, i.e., U.S. government securities and corporate and foreign bonds. In 1950, life insurance companies held 23 percent of pension fund reserves while private pension funds held 29 percent. Federal, state, and local government retirement funds comprised the remaining 48 percent. By 1985, life insurance companies controlled only 19 percent of pension fund reserves and private pension funds controlled 54 percent. As of year-end 1998, life insurance companies managed only 15 percent while private pension funds managed 50 percent and federal, state, and local government funds accounted for the remainder.

As the share of pension fund reserves held in private pension funds changed over time, so has the asset allocation within the private pension funds. In 1950, private pension funds held 15 percent of their financial assets in corporate equities and 73 percent in credit market instruments. In 1985, private pension funds held 27 percent of their assets in credit market instruments and 42 percent in corporate equities and mutual fund shares. At the end of 1998, the share of private pension fund assets in credit market instruments had fallen to 22 percent while 65 percent was in corporate equities and mutual fund shares. Thus, the asset allocation between equities and securities at the end of 1998 was nearly the reverse of what it had been in 1950. The dramatic shift to mutual funds and corporate equities also decreased the share of retirement assets invested in guaranteed investment contracts (GICs) and time and savings deposits.

The major factor driving these trends has been the gradual shift from defined benefit plans towards defined contribution plans. Historically, defined benefit plans dominated retirement coverage. In 1975, defined benefit plans covered 74 percent of workers covered by a retirement plan. By 1994, this share was only 47 percent and falling.[8] In terms of the share of assets held, defined benefit plans held more than 71 percent of the total market in 1975 compared with 53 percent in 1994.[9]

Two changes help explain this shift from defined benefit to defined contribution plans. First, a significant portion of the labor force moved from large manufacturing firms, which traditionally used defined benefit plans, to smaller, non-union firms, which often do not offer defined benefit plans to their employees.[10] Second, Congress enacted legislation in 1978 that

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[8] U.S. Department of Labor (1998), p. 67.

[9] *Ibid.*, p.73.

[10] For instance, in 1988, only 8.5 percent of workers in firms with less than 10 employees had pension coverage compared with 65 percent of workers in firms with 500 or more employees. *See* Lichtenstein (1992), p. 97.

paved the way for the introduction of a new type of defined contribution plan — the 401(k).[11] Unlike defined benefit plans, 401(k) plans permit each participating employee to make tax-deductible contributions to a separate account. To encourage employee participation, employers can make automatic and/or matching contributions to participants' accounts.[12] 401(k) plans also allow the individual employee to control the investment allocation decision.

The success of defined contribution plans is plainly evident in figure 1. They held $431 billion in assets in 1985. By the end of 1998 assets in these plans amounted to almost $2.2 trillion.[13] The number of defined contribution plans and participants have also grown dramatically. The number of defined contribution plans grew from 208,000 in 1975 to almost 616,000 in 1994. Over this same period, the number of defined benefit plans fell from 103,000 to 74,000. The number of participants in defined contribution plans also outpaced defined benefit plans. Although participants in defined benefit plans increased from 33 million in 1975 to 40 million in 1994, the number of participants in defined contribution plans grew from 12 million to 45 million.[14]

Mutual fund companies currently dominate the defined contribution field. Their market share has risen from a 21 percent share in 1991 to a 42 percent share in 1997. Conversely,

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[11] The 401(k) name refers to Section 401(k) of the Internal Revenue Code, which codified the Tax Reform Act of 1978 and the Revenue Act of 1978. 401(k) plans did not begin to appear until 1982 after the IRS issued proposed 401(k) regulations. *See* Miller and Phillips (1996, pp. 10-12) and Andrews (1992, pp. 149-152). 403(b) plans and 457 plans refer to 401(k)-like defined contribution plans for employees of nonprofit organizations and state and local governments, respectively.

[12] Employer and employee contributions are subject to limits. In order to qualify for tax-deferred status, these plans must also satisfy specific distribution, vesting, and nondiscrimination requirements. *See* Miller and Phillips (1996, pp. 45-65).

[13] Board of Governors of the Federal Reserve System (1999, Z.1).

[14] U.S. Department of Labor (1998a, pp. 63 and 67).

according to the Spectrem Group, banks administered only 21 percent of 401(k) assets at the end of 1997 compared with 28 percent in 1991. Insurance companies had a 22 percent share in 1997, falling from a 37 percent share in 1991.[15]

The increase in 401(k) plans is thus closely linked with the growth in mutual fund assets. Assets in employer-sponsored retirement plans were only 5 percent of all mutual fund assets in 1981. By 1998, these assets in retirement plans accounted for 18 percent of all mutual fund assets. According to the Investment Company Institute's estimate, assets from retirement plans (IRAs and employer-sponsored plans) accounted for 35 percent of total mutual fund assets at year-end 1998. The Investment Company Institute also estimates that mutual funds' share of 401(k) plan assets grew from 9 percent in 1990 to 42 percent in 1998.[16]

Although participants in defined contribution plans now make asset allocation decisions for their own retirement accounts, recent research suggests that employees who purchase mutual funds through employer-sponsored retirement plans may not have the information they need to make informed investment decisions.[17] For example, Alexander, Jones, and Nigro (1997) show that most retirement investors are less than financially literate and have only a limited knowledge of risks, fees, and expenses. A John Hancock Mutual Life Insurance Company survey of 401(k)

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[15] *See* Jacobius (1998, p. 21). Cerulli Associates places banks' share of the 401(k) market at 18.5 percent in 1997, up from 17 percent in 1994 (Waddell, 1998).

[16] *See* Investment Company Institute (1998a, p. 2, and 1999, p. 51). Employer-sponsored retirement plan assets include defined benefit plans as well as defined contribution plans.

[17] Section 404(c) of the Employee Retirement Income Security Act of 1974 (ERISA) relates to the fiduciary responsibility of retirement plans that allow participants to self-direct their retirement plan balances. If participants self-direct their account balances, Section 404(c) insulates plan sponsors from responsibility for poor investment results stemming from individual participants' investment choices. However, Section 404(c) does not diminish the sponsor's general fiduciary responsibility regarding prudent selection of investment options, periodic performance review of these investment options, and ongoing due diligence. *See* Miller and Phillips (1996, pp. 115-159).

plan participants found similar results. This survey revealed that more than one-third of the respondents believed it was impossible to lose money in a bond fund (an additional 12 percent were not sure), while 12 percent believed it was impossible to lose money in an equity fund or said they did not know.[18]

Some analysts have suggested that U.S. workers need to become better educated about the risks associated with investing their retirement savings. They have also raised concerns about the adequacy of fee disclosures. The Department of Labor has begun to address this issue by creating a one-page fee disclosure form that should address some of these concerns.[19] Similarly, the Profit Sharing/401(k) Council of America has prepared a profit-sharing and 401(k) plan worksheet intended to help employers determine a plan's total cost regardless of how providers structure their fees.[20]

Given the growth in defined contribution plans and such regulatory concerns, how do national banks active in this market view the growth, competitiveness, and risks of providing retirement services? The next section examines findings from the OCC study and discusses some of the larger issues currently shaping the industry including fees, services, and risks.[21]

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[18] *See* Schultz (1995).

[19] *See* Winokur (1998).

[20] The Profit Sharing/401(k) Council of America provides this cost disclosure worksheet free of charge through its Web site (www.psca.org). The Securities and Exchange Commission (SEC) has also undertaken initiatives to improve investor knowledge by releasing a profile prospectus and sponsoring investor education seminars.

[21] Several recent studies have looked at trends in the growing 401(k) plan market. These include the Department of Labor's Pension and Welfare Benefits Administration's *Study of 401(K) Plan Fees and Expenses* (U.S. Department of Labor, 1998b), Hewitt Associates' *Survey Findings: 401(k) Trends and Experience* (Hewitt, 1997), and Cerulli Associates' *The State of the Pension and Retirement Markets* (Cerulli, 1999). When appropriate, we will make comparisons between results from the large national bank study and findings from these other studies.

III. Study Results: Large National Bank Retirement Services

The Large National Bank Retirement Services Study provides data on a variety of retirement products that large national banks offer.[22] Information gathered applied to retirement services generally, including defined benefit plans, defined contribution plans, and 401(k) plans. Examiners reported information about asked large national banks about their retirement products and services, the markets they target, and their view of competition in retirement services. The study also provides a glimpse into how banks view the risks and opportunities of the retirement services market.

Twenty-three large national banks voluntarily participated in the study. Together, these banks have assets of more than $1.4 trillion and trust assets of more than $3.5 trillion. The average bank in the study had $75 billion in bank assets and $184 billion in trust assets. The banks ranged in trust-asset size from less than $10 billion to more than $1 trillion. The wide range in trust assets among these large national banks indicates that the level of involvement in this market varies greatly even among large banks. On average, retirement services account for roughly 30 percent of the banks' asset management income.

National banks in the retirement services market compete against service standards established by top tier providers. While standards of service constantly evolve in order to meet the demands of employers and plan participants, the Spectrem Group has identified a useful list of "best in class" service standards. These standards furnish a scale providers can use to measure their preparedness to meet the most vigorous competition. These standards include:

[22] The questionnaire examiners completed is shown in Appendix A.

- **Communication with Employees –** Employers or providers increasingly see this element as the distinguishing characteristic of a competitive plan. It includes the ability to customize materials; provide education on investments; conduct on-site employee meetings; and provide services such as newsletters, financial planning software, Internet access, and the inclusion of individual investment performance on periodic statements.

- **Investment Management –** This standard includes the ability to choose among multiple fund families, both proprietary and external. Choice of name brand funds, low-cost management, solid performance, and an established track record are important characteristics.

- **Trustee Services –** Employers often overlook the importance of these services when considering the value added by a provider. Many providers include the cost of trustee services in their base fee. Trustee services include fiduciary responsibility and liability (a higher standard of expertise and service), custody, trade settlement/clearance, asset reconciliation to mutual fund companies, and compliance reporting.

- **Participant Servicing / Record Keeping –** State-of-the-art daily valuation and record keeping services are an increasingly key criteria in provider selection. Sponsor companies also look for statement and transaction processing models that meet or exceed industry standards. Sponsors are pushing providers to increase functionality of voice response centers with enhancements such as multilingual or hearing-impaired capability, on-demand fax, and access to a plan's account information.

Answers from the study questionnaire provide a measure of how the banks in our study compare to these best-in-class standards. The answers also illustrate some of the differences and similarities among large national banks providing retirement services.

A. The Retirement Products Large National Banks Offer

The variety of retirement products that banks offer mirrors the wide range of products available in the overall retirement services market. These products include 401(k) plans, profit-sharing plans, money purchase pension plans, non-qualified and other defined contribution plans, and defined benefit plans. As table 1 shows, 21 of 22 banks in the study administer defined benefit plans and all 22 administer defined contribution plans.[23] Twenty-one banks indicated that they administer 401(k) plans, making 401(k) plans the most frequently offered type of defined contribution product. Thirteen banks indicated that they offer other defined contribution plans such as Employee Stock Ownership Plans (ESOPs), 403(b) plans, and 457 plans.[24]

Table 1. Managed Assets and Total Assets Under Administration
(dollars in millions)

Categories	Number of Responses		Total Assets	Average Assets	Total Managed Assets	Average Managed Assets
	Total (n=22)	Managed (n=18)				

[23] Although 23 banks participated in the study, examiners were not able to answer every question. The second number in each of these comparisons, 22 in this first instance, represents the number of actual responses to the question.

[24] ESOPs are defined contribution plans that invest primarily in employer securities. 403(b) and 457 plans are 401(k)-like plans for employees of nonprofit organizations and state and local government employees, respectively. Profit-sharing retirement plans receive the employer's contribution from profits. Money purchase plans determine the employer's contribution for each participant, usually as a percentage of compensation.

401(k) Assets	21	16	$149,910	$7,139	$43,959	$2,747
Profit Sharing Assets	19	16	$59,376	$3,125	$16,327	$1,020
Money Purchase Pension Assets	18	15	$19,554	$1,086	$4,459	$297
Other Defined Contribution Plans*	13	9	$24,721	$1,902	$2,971	$330
Total Qualified Defined Contribution Plan Assets	22	18	$343,838	$15,629	$71,832	$3,991
Total Nonqualified DC Plans	18	14	$11,433	$635	$1,792	$128
Total Defined Benefit Plan Assets	21	17	$489,301	$23,300	$49,500	$2,912
Total Institutional Custody Assets	15	11	$731,180	$48,745	$47,101	$4,282
Other Products*	14	12	$52,976	$3,784	$17,492	$1,458
IRA Assets	12	8	$5,985	$499	$990	$124

Note: The sample consists of 23 participating banks. The "n" in a column heading indicates the number of actual answers to a particular question. For instance, 22 banks answered the total assets section of table 1 while only 18 provided managed assets. "Other Defined Contribution Plans" and "Other Products" include ESOPs, 403(b), 457, thrift, Keogh, VEBA, SEP, passive trusts, Rabbi trusts, SERP, KSOP, 501(c)9, TexPool, Group IRAs, Health and Welfare, Corporate Assets, miscellaneous MIS reporting capacities, agency capacities, and cash management relationships, public plans, and master trusts.

Table 1 also shows that almost all banks in the study offer defined benefit plans and that these plans account for a larger share of retirement services assets than defined contribution plans. The large national banks in the study hold assets of defined benefit plans and defined contribution plans in about the same proportion as the banking industry as a whole. In 1998, financial assets of private pension fund reserves were evenly divided between defined contribution plans and defined benefit plans.[25] However, the defined contribution share of private pension funds has increased steadily, from 44 percent in 1990 to 51 percent in 1998.

Although defined contribution and defined benefit plans have approximately equal shares of retirement assets industry-wide, there is a striking difference in the relative importance of the two plans at individual banks in the study. Table 2 shows that on average defined contribution plans and defined benefit plans have roughly equal shares of retirement services assets with 32 percent and 27 percent, respectively. However, the defined contribution share of retirement assets at individual banks ranged from less than 5 percent to more than 90 percent. This broad range applies to 401(k) plans as well. While 401(k) plans averaged 19 percent of retirement assets, they varied in importance across banks in the study from roughly 3 percent of retirement assets to 64 percent. Similarly, the assets of defined benefit plans ranged from 2 percent to 80 percent of retirement assets.

Even though the relative importance of 401(k) plans varies greatly from bank to bank, twice as many banks that currently offer 401(k) services expect to expand these services in the next three to five years as expect to expand their defined benefit plan assets. As shown in table 2, 20 out of 23 banks expect 401(k) plans to expand over the next three to five years, while only

[25] Board of Governors, 1998, Tables L.119b and L.119c.

Table 2. Retirement Products and Services

Product	Banks Currently Offering (n=22)	Average Share of RS Assets*	Share Min.	Share Max.	Banks Planning to Introduce in 1-3 years	Planning to Expand (n=23)	Planning to Contract (n=23)
401(k) Plans	21	19.0%	3.1%	64.0%	0	20	0
Profit Sharing	20	9.7%	0.7%	48.7%	0	8	0
Money Purchase Pension	18	2.7%	0.1%	10.0%	0	8	0
Other Defined Contribution Plans	10	4.9%	0.4%	14.1%	2	1	2
Total Defined Contribution	21	32.3%	4.4%	91.0%	NA	NA	NA
Nonqualified DC Plans	18	1.4%	0.0%	5.3%	3	14	0
Defined Benefit Plans	21	27.4%	2.0%	80.0%	0	10	0
Institutional Custody	17	39.9%	1.0%	88.9%	0	8	1
Other Products	14	13.3%	1.6%	57.9%	0	2	1
IRAs	13	3.0%	0.0%	13.0%	0	12	0

Note: The share numbers in this table reflect the products offered as a percentage of total retirement services assets. “Other Products” include investment management and a “WRAP” program.

half as many expect defined benefit plans to expand over the same period. Nonetheless, none of the banks indicated that they expect to contract defined benefit products.[26]

Consistent with the general view toward expansion, only four banks expect any of their retirement products to contract over the next five years. Two banks expect ESOPs to contract and another foresees contraction in plans that serve fewer than 25 participants.

B. The Retirement Services Large National Banks Offer

In addition to offering a broad range of retirement products, banks also provide a wide array of retirement services. All the banks that responded to this question offer daily record keeping and assistance over the telephone (voice response). At least 19 of the 22 banks also send education materials to participants, host communication meetings for employees, supply client representatives, design and test the plan for nondiscrimination compliance, file compliance forms (Form 5500) with the IRS, and provide record keeping. Besides these core services common to all or most banks, some banks offer other services such as Internet capability and paperless transactions.

1. Core Services

We define core service as a service provided by 19 or more banks in the study. Table 3 identifies nine core services and several that are likely to become core services. Of the nine core services, most are among the Spectrem Group's best-in-class standards: daily record keeping,

[26] More than half of the banks in the study also expect to expand non-qualified defined contribution plans and IRAs. Non-qualified plans generally are executive compensation plans that cannot receive the special tax advantages of qualified plans because they fail to cover 70 percent of employees who are not highly paid.

Table 3. Retirement Services

Service	Banks Currently Offering (n=22)	Banks Planning to Introduce in 1-3 years	Planning to Expand (n=23)	Planning to Contract (n=23)
Daily Record Keeping	22	0	15	0
Traditional Record Keeping	19	0	2	8
Participant Education Materials	21	0	19	0
Employee Communication Meetings	21	0	18	1
Plan Design Compliance	20	0	10	0
Benefits Consulting	9	3	7	0
Voice Response	22	0	15	0
Client Service Representative	20	1	16	0
Financial Planning	5	11	13	0
Form 5500 Filing	20	1	9	0
Internet Capability	10	NA	NA	NA
Internet Inquiry	10	12	15	0
Internet Transactions	3	17	14	0
Self-directed Brokerage Accounts	13	NA	NA	NA
Self-directed Brokerage Accounts: Manual Processing	10	2	2	3
Self-directed Brokerage Accounts: Automated	3	14	12	0
Paperless Loans	13	9	14	0
Paperless Distributions	5	11	8	0
Compliance Testing	20	0	7	0
401(k) Compliance Testing	18	NA	NA	NA
Other Services*	9	2	0	0

Note: “Other Services” listed include benefits testing, tax withholding, 1099 reporting, trustee and investment management services, pension disbursements, Section 125 administration, computer models for retirement calculations, 410(b) services, 401(a)(26) services, and individual-directed accounts.

participant education materials, employee communication meetings, voice response, client service, and compliance reporting. Fifteen or more banks in the study also expect to expand most of these best-in-class services over the next three to five years.

Although all banks in the study currently offer daily valuation of assets, fifteen banks expect to expand this service over the next five years. On average, banks currently value 68 percent of their 401(k) assets each day. Within five years they expect to be valuing 90 percent of their 401(k) assets each day.

Most banks in the study do not currently offer several other best-in-class standards. These scarcer best-in-class services include financial planning, benefits consulting, and Internet access. Nine banks offer benefits consulting; only three more intend to introduce this service within the next three years. While only five banks in our study offer financial planning, 11 intend to introduce it.[27]

2. Technology-based Services

The study also revealed variations among banks in their application of technology to retirement services. For instance, table 3 shows that customers of 10 of the banks in our study can make account inquiries over the Internet, but only three of the banks allow Internet transactions. Table 3 also shows that 13 of the 22 responding banks offer paperless loans, but only five offer paperless distributions. Similarly, although 10 banks offer manual processing of self-directed brokerage accounts, only three banks offer automated processing of these accounts.

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[27] Some providers have also begun to offer specific investment advice to plan participants (Ferrer (1998, p. 105). For example, Financial Engines Inc., a provider of online investment advice, recently introduced an Internet-based advisory service that provides personalized investment advice for 401(k) plan participants. Ernst and Young LLP and State Street Global Advisors have agreed to use the online advisory service with their 401(k) plan offerings (Financial Engines Inc., 1998).

Many banks that do not currently offer technology-based services expect to be able to offer some of these services within the next three years. As table 3 shows, the 12 banks in the study that do not currently offer Internet inquiries expect to offer this service within three years. Eleven of these 12 expect the service to be available within one year. Although only three banks currently offer Internet transaction services, 17 more expect to offer this service within three years (13 of the 17 expect Internet transactions to be available within one year).

Self-directed brokerage accounts with automated processing, paperless loans, and paperless distribution features are three other technology-based services that many banks will offer soon. Within three years, 14 of the banks in our study expect to begin offering automated processing of self-directed brokerage accounts, 9 expect to offer paperless loans, and 11 expect to offer paperless distributions.[28] Together, these results suggest that Internet inquiries and transactions along with paperless loans and distributions may become core services within three years.

C. Markets for Large National Bank Retirement Services

1. Geographic Markets for Retirement Services

The national banks in our study tend to direct sales of retirement services toward mid-sized firms in regional geographic markets. Table 4 shows that while most national banks focus on a regional geographic market for all of their retirement products, one-third target the national

[28] With roughly 50 percent of the banks in our study currently offering self-directed brokerage accounts with at least manual processing, large banks appear to be more likely to offer these accounts than other plan providers. The Department of Labor cites two studies that report that less than 5 percent of plans offer participants access to a self-directed brokerage account. Hewitt Associates reports that 5 percent of plans offered this option in 1997, compared with less than 1 percent in 1995. *See* U.S. Department of Labor (1998b, section 2.4.5) and Hewitt (1997, p. 19).

market. None of the banks in the study pursue only a single state or local market. The 401(k) plan is the retirement product banks most often direct toward the national market (eight of 23 banks).

Table 4. Markets for Retirement Services
(23 banks responded)

Product	Geographic			Plan or Company Size		
	National	Regional	State or Local	Large	Middle-sized	Small
Defined Benefit	6	17	0	10	22	7
Defined Contribution w/o 401(k)	5	18	0	9	22	13
401(k)	8	15	0	13	22	15
Nonqualified	5	16	0	6	16	8
Institutional Custody	4	14	0	10	14	4
Other	0	3	0	0	1	0

Note: Some banks gave multiple responses. The table reflects only the widest geographic area cited, but all of the size responses.

2. Size of Companies Banks Target for Retirement Services

Many banks choose to market retirement services to companies of all sizes. The study also shows that what is one bank's "small market" may be another bank's "middle market." On average, banks defined small-market firms as having plans with fewer than 300 participants or less than $3 million in assets. However, while one bank defined small market firms as having fewer than 50 employees, another bank defined the same market as having fewer than 1,000 employees. Similarly, banks differ in their delineation of the middle and large market, with respondent characterizations of the middle market ranging from 500 to 5,000 employees. On average, banks in the study identified middle-market firms as having plans with between 360 and 3,800 participants or between $4 million and $41 million in assets. Large market firms on average have plans with more than 2,700 participants or greater than $39 million in assets.

Table 4 also presents data on banks' target market based on company size (a plan's participants or assets). All but one bank responded that they target the middle market for defined benefit plans and defined contribution plans, including 401(k) plans. Small and large markets receive roughly equal attention, although more banks target 401(k) plans toward small market firms than toward large market firms.

Most banks indicated that they pursue at least two different markets with respect to firm size. 401(k) products are especially likely to have more than one market. Only four banks indicated that they focus only on the middle market for 401(k) products. Nine banks target at least two markets for 401(k) plans and nine banks strive for all three markets.

3. International Markets

Institutional Investor's *1998 Defined Contribution Directory* suggests that defined contribution providers are expanding their overseas markets. Although the overseas presence is still small (just $3 billion in foreign assets compared with the $2 trillion U.S. defined contribution industry) 13 percent of the directory's defined contribution providers (20 out of 156) report having business overseas.[29]

Most banks do not currently appear to be interested in extending their retirement services into the international arena. Eighteen of the 23 banks in the study do not have plans to offer

[29] Ferrer (1998, p. 105).

retirement services to residents of foreign countries. Of the five banks that do plan to offer international retirement services, only one indicated that it is already providing this service.

D. Fees

Pension regulators, employers, and plan participants are increasing their scrutiny of fees for defined contribution plans. They have two reasons for doing so. First, participants in defined contribution plans shoulder most of the responsibility for making investment allocation decisions, whereas they bear none of this responsibility in defined benefit plans. Second, recent surveys suggest that 401(k) plan participants are paying an increasing share of plan fees and expenses.

Because a plan's fees and expenses affect an investment's return over time, a plan's participants and sponsors need to know the costs associated with various options. Using this information, they can choose a defined contribution plan that maximizes potential investment return for a given set of services.

Under defined benefit plans, retirement income depends primarily on the employee's final salary and job tenure.[30] Because defined benefits are independent of a plan's fees and expenses, the burden of finding and funding the lowest-cost, highest-yielding defined benefit plan rests solely with the employer. In a defined contribution plan, however, retirement income depends on contributions to the plan and the investment return on those contributions. High fees and expenses will lower an investment's return and, consequently, retirement income.

[30] In 1993, 61 percent of all full-time defined benefit participants had benefit formulas based on final earnings. Twenty-two percent of defined benefit participants had benefits based on years of service multiplied by a fixed dollar amount. *See* Employee Benefits Research Institute (1995, p. 165).

The OCC's study and several other recent studies of 401(k) fees show that plan fees vary widely. Fees vary not only from provider to provider but also for a single provider offering various service options. This suggests a two-step search for low-cost defined contribution plans. First, an employer must select a low-cost provider from the multitude of retirement service providers. Second, the sponsor must select service options from that provider that will maximize value for the combination of services and investment risk that a participant chooses.

1. Defined Benefit and Defined Contribution Fees

Table 5 shows the different fees banks charge for defined benefit and defined contribution plans. Most banks in our study charge some fees, e.g., trustee fees, investment management fees, and distribution fees, whether the product is a defined benefit or defined contribution plan. However, banks apply other fees, e.g., participant record keeping, loan fees, base fees,

Table 5. Fees for Retirement Services
(in basis points unless currency noted)

Fee	Defined Benefit (n=21)		Defined Contribution w/o 401(k) (n=20)		401(k) (n=21)	
	Banks	Avg. Fee	Banks	Avg. Fee	Banks	Avg. Fee
Trustee	14	43.0	16	89.2	14	41.1
Investment Management	18	52.1	17	52.3	15	51.2
Custodial	15	14.5	15	16.5	11	17.7
Transaction	13	$18.4	13	$18	9	$19
Participant RK	1	$12.5	16	$23	18	$21
Loan Fee	4	$87.5	16	$76	17	$76
Base Fee	8	$1,914.3	14	$1,832	16	$2,179
Compliance Testing	1		11	$231	10	$285
Distribution Fees	16	$14.0	17	$14	17	$14
Insurance Processing	3	$17.5	4	$11	4	$14
Administrative	4	20.0	7	20.0	8	24.4
12b-1	4	15.3	7	22.7	13	26.8
Sub transfer agent	2	$37.5	4	25	10	14
Finders	0		3	31.3	5	56.3
Investment Advisory	4	37.4	6	36.2	6	33.9
Other*	1		5		7	

Note: The "Banks" column shows the number of banks that charge each fee. Most respondents provided a range for their fees. The average fee calculated uses the midpoint of the range. "Other" fees listed include sub-accounting fees, education fees, base participant record keeping fees, and employee communication fees.

compliance testing, and 12b-1 fees, to defined contribution plans more often than to defined benefit plans.[31] Appendix B is a fee glossary.

The number and size of fees banks charge for retirement services vary widely from bank to bank. However, while differences in the number of fees charged reflect different fee structures, the differences may or may not carry over to differences in the total expense of the various plans. For example, one 401(k) provider may charge a single investment management fee while another provider may charge a lower investment management fee but apply separate charges for record keeping or loan fees. The total expense of a particular plan, therefore, depends on these various fees and how often plan participants use services with separate charges.

The total cost of a particular plan ultimately depends on the amount of the plan's assets, the number of people participating in the plan, the services desired from the plan's provider, and negotiation between the employer and the plan's provider. Other factors that affect plan fees and expenses include investment options, portfolio turnover, and the behavior of plan participants.

2. 401(k) Plans' Fees

A recent study of 401(k) trends and fees suggests that plan participants may be paying a growing share of plan expenses. A 1997 Hewitt Associates survey, *Survey Findings: 401(k) Trends and Experience*, compares survey data over several years. The comparison shows a

[31] Most banks provided a range for their fees, and many of these ranges were zero at the low end. A zero fee may occur when banks waive management fees on assets invested in proprietary mutual funds or when some of the cost is included in another fee, e.g., an investment management fee or the annual base fee. Banks in the OCC study charge an average of nine fees for their 401(k) plans. The number of fees charged by individual banks ranged from a single bundled fee to as many as 15 separate fees.

gradual shifting of a plan's expenses from employers to participants.[32] In 1997, participants paid all investment management fees (other than mutual fund management fees) in 56 percent of 401(k) plans compared with 44 percent in 1991. The share of plans requiring plan participants to pay fees also increased between 1991 and 1997 for audit fees, employee communication, record keeping, and trustee fees. For instance, participants paid all record keeping fees in 35 percent of plans in 1997 and 22 percent of plans in 1991. They paid trustee fees in 40 percent of plans in 1997 and 27 percent in 1991.

Some plans divide expenses between employers and a plan's participants, but only a small fraction of 401(k) plans use this shared- expense approach. For instance, less than 10 percent of 401(k) plans in the Hewitt survey share investment management fees (other than mutual fund management fees), record keeping fees, and trustee fees.

The Department of Labor's Pension and Welfare Benefits Administration's April 1998 *Study of 401(K) Plan Fees and Expenses* found a wide range of fees among plan providers and within individual fund categories. For example, expense ratios charged for the management of mutual funds depend on the fund category and whether the fund is an index fund or an actively managed fund. Expense ratios for growth and income funds for the year ending October 31, 1996 ranged from a low of 19 basis points for an S&P 500 index fund to a high of 301 basis points for an actively managed fund, a difference of 282 basis points. The difference between the low and high expense ratios in the growth fund category was 629 basis points.[33]

The Department of Labor study also cites a survey of 17 major 401(k) providers to show how plans' expenses vary widely. For a plan with 100 participants and $2 million in assets,

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[32] Hewitt Associates (1997), pp. 45-46. Hewitt conducted similar 401(k) surveys in 1991, 1993, and 1995.

[33] *Fortune*, December 23, 1996.

projected expenses varied among the 17 providers from a low of 57 basis points to a high of 214 basis points. The mean was 132 basis points and the median was 128 basis points. [34]

Fees and expenses at individual providers also varied widely, largely because of variations in the plans' assets and number of participants. The Department of Labor study estimates that the average total costs of a 401(k) plan with 100 participants and $3 million would be 140 basis points. For a plan with 2,000 participants and $60 million in assets, the average total cost would be 110 basis points.

Table 5 shows average fees from banks participating in the OCC study. Most fees are nearly the same whether they apply to a defined benefit plan or a defined contribution plan. The average trustee fee for defined benefit plans and 401(k) plans is roughly 40 basis points.[35] The average investment management fee across all plans is approximately 50 basis points, the average custodial fee is 16 basis points, and the average base fee is $2,000. The Department of Labor study reports that set-up fees or base fees range from $500 to $3,000. Among the fees at large national banks that apply primarily to defined contribution plans, the average record keeping fee is $22 per plan participant and the average loan setup fee is $76. The Department of Labor study reports the average 401(k) plan record keeping fee in 1995 was $42 for a plan with 200 participants and $34 for a plan with 1,000 participants. [36]

E. Competition in Retirement Services

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[34] Department of Labor (1998b), section 3.6.

[35] Trustee fees for defined contribution plans other than 401(k) plans are the exception because they are more than double the other products' average trustee fees.

[36] The average fee uses the midpoint of the range provided and may not reflect what a typical plan might pay. The Hewitt study reports that loan application fees for approximately 200 plans ranged from $3 to $100 with the median fee $40. Hewitt also reports that loan servicing fees ranged from $3 to $75 per year among 100 plans reporting these fees. The median loan servicing charge reported was $15 per year.

1. Banks Rank the Retirement Services Competition

Banks face stiff competition in the retirement services market. In addition to competing with other banks, they compete with mutual fund complexes, brokerage firms, insurance companies, investment management firms, benefit consulting firms, accounting firms, and third-party providers.

Table 6 shows firms that banks participating in the OCC study viewed as their primary competitors in the retirement services market and how they rank the competition.[37] All banks identified mutual fund complexes as competitors and almost always ranked them as their strongest competition. Two banks cited other banks and brokerage firms as their strongest competitors.

Most banks also identified other banks, insurance companies, and brokerage firms as primary competitors. "Other banks" were ranked 2.5 as competitors, second only to mutual fund complexes. Insurance companies and brokerage firms tied for the third highest ranking as competitors. Each had a 2.9 ranking. Less than half of the responding banks identified third-party providers, investment management firms, benefit consulting firms, and accounting firms as primary competitors.

[37] Examiners asked banks to rank the competition on a scale from 1 to 5, with 1 being the strongest competition. Some banks gave identical numerical rankings to several competitors.

Table 6. Competition in the Retirement Services Market

Competitor	Responses (n=22)	Rank					
		AVG	1	2	3	4	5
Mutual Fund Complexes	22	1.1	19	1	0	0	0
Insurance Companies	20	2.9	0	9	6	3	2
Brokerage Firms	20	2.9	2	5	6	4	2
Other Banks	17	2.5	2	7	2	4	0
Third-Party Providers/ Administrators	10	4.0	0	0	3	3	3
Investment Management Firms	9	3.5	0	1	3	3	1
Benefit Consulting Firms	7	3.4	0	1	3	2	1
Accounting Firms	5	4.2	0	1	0	1	3
Other	0		0	0	0	0	0

Note: Banks ranked the competition on a scale of 1 to 5, with 1 being the strongest competition. Some banks gave a response without a ranking (i.e., rows may not add to total responses) and some banks gave more than one response for different ranks (i.e., sum of columns may exceed 23).

2. Banks' Competitive Advantages and Disadvantages

Table 7 presents data on how banks view their advantages and disadvantages as they compete in the retirement services market. Banks most often cited superior customer service and customer relationship-building as competitive advantages: 19 of 23 banks identified superior customer service while 18 of 23 banks indicated customer relationship-building. Most banks also cited investment management services, the bank's reputation, the bank's distribution channels, and its ability to cross-sell related financial services as advantages. While many banks in the study believe that the quality of their customer service works to their advantage, only six of 23 banks saw either price or automation as a competitive advantage.

In fact, banks in the study viewed their automation capabilities as working to their disadvantage. While banks in the study most often cited stiff competition as a barrier to expansion, many banks identified automation elements such as undeveloped capabilities in multiple system interfaces (automated processes) and core systems as representing competitive disadvantages.

Roughly a quarter of the banks in the study also identified regulatory burden, training, and staffing issues as disadvantages. Only a few banks in the study selected management depth and inexperience, regulatory or legal uncertainty, or a limited product array as competitive disadvantages.

3. Competitive Disadvantages in the 401(k) Market

Examiners asked study participants whether they had any shortcomings in the 401(k) market and which two shortcomings they considered most important to remedy. Table 8 presents the banks' responses to this question. Several of these responses mirror disadvantages mentioned regarding the broader retirement services market. For instance, 10 banks identified lack of advanced technology as a shortcoming, and six of these 10 ranked it as their most significant problem.

Table 7. Banks' Competitive Advantages and Disadvantages in Retirement Services

	Responses (n=23)	
ADVANTAGES	Superior Customer Service	19
	Customer Relationship Building	18
	Bank Reputation	17
	Investment Management Services	17
	Bank Distribution Channels	16
	Cross-selling Related Financial Services	16
	Automation Capabilities	6
	Price	6
	Other Advantages*	5
	Responses (n=22)	
DISADVANTAGES	Competition	15
	Undeveloped Multiple System Interfaces	11
	Staffing Issues: Relocation/Retraining	9
	Core System Capabilities	7
	Training Issues	6
	Regulatory Burden	6
	Limited Product Array	3
	Regulatory/Legal Uncertainty	2
	Management Depth and Experience	1
	Inexperience with Product/Service	1
	Other Disadvantages*	5

Note: "Other" advantages: customized education and multiple fund options, national capabilities, regional service capabilities, local service, service quality guarantee, superior enrollment and education capability, employee communications, and executive services. "Other" disadvantages: lack of brand recognition, name recognition outside primary markets, organizational structure, bank image, industry uncertainty, Internet access, achieving scale in some businesses, achieving prompt time to market for product innovations, low level of investment in product area including marketing and sales, weak sales/marketing culture.

Table 8. Bank Shortcomings in the 401(k) Market

Shortcoming	Responses (n=20)	Ranked One	Ranked Two
Advanced Technology	10	6	0
Brokerage Account Links	10	1	5
Financial Planning Services	7	2	4
Manual Processes	6	3	2
Core Record Keeping System	5	2	2
Benefits Consulting Services	4	1	2
Investment Track Record	2	1	1
Daily Valuation	2	1	0
Experienced Personnel	2	0	2
Participant Education / Communication	2	0	1
Broad Array of Products (Product Development)	1	1	0
Comprehensive Fund Offering	0	0	0
Plan Design Services	0	0	0
Compliance Testing	0	0	0
Other*	6	2	2

Note: Banks also ranked the two highest priority shortcomings. "Other" responses include management information systems, availability of qualified personnel, Internet capability, Internet services, and NSCC connectivity.

Several banks also ranked their manual processes, record keeping systems, brokerage account links, financial planning services, and benefits consulting services as competitive disadvantages. Only one or two banks mentioned daily valuation, participant education and communication, personnel experience, investment track record, or product array as shortcomings. Not a single bank in the study indicated weaknesses in compliance testing, plan design services, or comprehensive fund offering. Six banks, however, cited other weaknesses. These included management information systems, the availability of qualified personnel, and Internet capability.

Banks in the study also indicated how they plan to address these shortcomings. Fifteen of 20 banks stated that they would improve their products or services internally and 12 banks said they would form an alliance or partnership. Six banks said they would acquire a third-party provider and seven banks mentioned other means, such as purchasing Internet software, using third-party vendors, outsourcing, and undertaking extensive recruiting and training.

Banks also ranked their top two strategic goals for retirement services. Table 9 shows which strategic goals the banks identified. Banks most often cited their desire to improve the utilization of their delivery system, broaden their product mix, and diversify income sources. The objectives identified least often were to acquire a third-party provider and to maintain the status quo.

F. Risks Associated with Retirement Services

Retirement services present a variety of potential risks to banks that offer these services. For example, Ouimette (1998) has suggested that 401(k) record keeping problems may create potential transaction and reputation risks. In general, new competitive pressures and

Table 9. Strategic Goals for Retirement Services Products
(23 banks responded)

Goal	Ranked 1	Ranked 2
Improve Utilization of Delivery System	8	6
Broaden Product Mix	8	3
Add To and Diversify Income Sources	7	3
Meet Competition	2	5
Form Alliance/Partnership	2	0
Acquire Third-Party Provider	0	0
No Change	0	0
Other*	2	3

Note: Some banks gave more than one response for goal ranked one and no response to goal ranked two. Hence, columns do not sum to 23. "Other" goals listed include increase profitability, expand defined contribution penetration, grow sales, and grow net contribution.

technological demands placed on providers create additional hazards as the industry continues to shift toward defined contribution products.

1. Risks to Large National Banks

The large national banks in our study appear to be aware of the many risks that can arise in retirement services. Banks identified which of the OCC's established risk categories they associate with retirement services; whether they consider each of these particular risks to be of low, moderate, or high significance; and whether they view the level of risk as stable, increasing, or decreasing.[38] Table 10 presents a summary of the banks' responses. At least 20 of the 23

[38] The OCC's risk categories are reputation, strategic, compliance, transaction, credit, price, interest rate, liquidity, and foreign exchange. A moderate risk is one that is modest and manageable. A high risk is significant but not necessarily unmanageable.

banks indicated that they associate reputation risk, strategic risk, compliance risk, and transaction risk with retirement services. Most banks in the study consider these risks to be of either low or modest significance, and most also view these risks as decreasing or stable.

All 23 banks participating in the study recognize the potential risk to the banks' reputation. Almost as many banks in the study associate compliance, strategic, and transaction risks with retirement services. Price risk was cited by roughly half of the banks in the study.

As for other OCC risk categories, only three or fewer of the 23 banks in the study associate credit risk, interest rate risk, liquidity risk, or foreign exchange risk with retirement

Table 10. Risks Associated with Retirement Services Products
(23 banks responded)

Risk	Level			Trend			NA
	Low	Medium	High	Decreasing	Stable	Increasing	
Reputation	3	14	6	2	18	3	0
Strategic	7	7	6	0	14	6	0
Compliance	2	10	9	3	12	7	0
Transaction	3	11	8	2	14	6	0
Credit	3	0	0	1	2	0	14
Price	6	4	2	1	5	6	7
Interest Rate	1	0	0	1	0	0	16
Liquidity	3	0	0	2	1	0	14
Foreign Exchange	2	0	0	1	1	0	15
Other	1	1	1	0	2	1	1

Note: Banks designated "NA" if the risk does not relate to retirement services.

services. All of the banks identifying these risks say they are of low significance and either stable or decreasing.

While a majority of the large banks in the study consider reputation, strategic, compliance, and transaction risks to be modest, roughly a fourth believe they have high significance. Similarly, although the majority considers these risks to be stable or decreasing, roughly a fourth believe they are increasing. These two views may reflect how greater demands for service, increasing expectations for technological capabilities, and greater competition have brought dramatic changes and significant challenges to some national bank providers of retirement services.

Participating banks were asked to use their own words to identify the top three risks that they associate with retirement services. Table 11 lists the responses from the 22 banks that responded. The answers varied, but several risk categories appeared consistently among the banks' top three risks. Some of the risks mentioned frequently are similar to those just discussed, i.e., compliance risk, transaction risk, strategic risk, and reputation risk. Among these four risks, compliance or regulatory risk appeared in the top three 11 times, transaction or operations risk appeared 10 times, strategic risk appeared five times, and reputation risk appeared four times.

Banks in the study also frequently placed price-compression/competition risk, technology risks, and fiduciary risks in the top three. Pricing or competition issues appeared 10 times, and technology risks and fiduciary risks each appeared eight times. Staffing and market risks were also on their lists, but not as often. Staffing appeared four times and market risk appeared twice.

Table 11. Top Risks Bank Managers Associate with Retirement Services
(22 banks responded; the number of responses in each category is in parentheses.)

Risk Category	Response
Compliance/ Regulatory (11)	Compliance (4); compliance – complex and frequently changing regulations cause confusion among a plan's sponsors; compliance with ERISA, tax laws, and related documents; ERISA-related, plans not in compliance; changing government and regulatory environment; regulatory/compliance changes; legislation that may develop; regulatory
Pricing/ Competition (10)	Pricing Risk; market pricing pressure; price risk – risk of compression 3-5 years away; growing profitability – price compression; competition; Competitive pricing – ability to remain profitable; competitive pricing – margin squeeze on daily valuation product; competition willing to “buy” business; underestimating cost bidding for new business; profitability – increase in technology investments required to maintain competitive product. Training and personnel expenses are increasing, again related to compliance risk.
Transactions/ Operations (10)	Transactional; transaction (2); transactions/operations with increasing competition; operating risk – timeliness and accuracy of money flows; failure to process transactions timely and accurately; execution risks in daily trading; processing/transaction risk in the daily valuation environment; incorrect allocation postings; transaction risk – customer service processing, contributions, distributions, etc. in billions of dollars.
Technology (8)	Cost of Technology (2); changing technological environment; technology – develop Internet technology; staying current technologically – e.g., providing Internet capabilities; increasing complexity of business – systems, investment options, and transactions; systems; systems-related risks
Fiduciary (8)	Proper definition of roles and responsibilities between client and bank; de facto co-fiduciary in client's perception (sponsor and participant); excellence in fiduciary responsibility – training, loss prevention, poor quality; fiduciary; improper interpretation of plan documents; participants reaching retirement without enough assets; legal risk – participant underachieving; failure to administer accounts in accordance with trust/plan document
Strategic (5)	Strategic (2); strategic/technological risk; strategic risk – constant review of products and services to compete; strategic – how to grow the business and be profitable (incl. Tech and product development)
Staffing (4)	Training, staffing; employee turnover/training; maintaining quality workforce
Reputation (4)	Reputation (3); bank image
Market (2)	Financial markets volatility; market – employee expectations for equity returns high after significant bull market. When prolonged market correction occurs, litigation may occur.
Other (4)	Investment (2); plan sponsor preparedness for Y2K; failure to adequately screen new accounts/assets to prevent problem/risk accounts from being accepted

2. Risk Management

In the study, banks also identified the risk management techniques or systems they use for retirement service activities. All 23 banks rely on audit procedures and 21 of the 23 banks use internal controls or legal resources dedicated to retirement services. Twenty of the 23 banks use compliance or risk management resources dedicated to retirement services and 18 use personnel with overall trust compliance or risk management responsibilities for risk management. Fifteen banks indicate they use quality assurance testing and reporting programs.[39]

Awareness on the part of senior bank management is an important part of risk management. Table 12 shows what information related to retirement services banks include in reports to senior management. All 23 banks report income and expenses, new and lost business, litigation, and audit and internal control issues. Twenty-one of 23 report new product initiatives and product sales and trends. At least 16 of the 23 banks also report on consumer complaints, exception reports, and quality control.

The risks posed by retirement services can lead to financial losses: four of the 23 banks in the study report losses or extraordinary charges of greater than $1 million within the prior year. Although these losses were relatively small (they ranged from $1.1 million to $14.9 million) the four banks had combined losses of $20.4 million. The banks identified errors in daily valuation operations as the cause of the losses.[40]

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[39] Other responses included retirement services oversight committee, statewide compliance officer, design review for new products, risk assessment, corporate compliance, control accountability system, account risk ratings, client surveys, and outside legal counsel.

[40] A later disclosure to examiners revealed that at least one other bank is projecting losses because of 401(k) record keeping difficulties.

Table 12. Retirement Services Information Included in Reports to Bank Management

Information	Responses (n=23)
Audit/Internal Control Issues	23
Income/Expense	23
New/Lost Business	23
Litigation	23
Product Sales and Trends	21
New Product Initiatives	21
Consumer Complaints	17
Quality Control	17
Exception Reports	16
Other*	1

Note: Bank management refers to senior management overseeing retirement services. "Other" response is profitability by product line.

Litigation poses another risk for retirement service providers. Over the past five years, five of the 23 banks in the study have been involved in a lawsuit with a potential claim of at least $1 million. Three of these cases were class action suits. The total amount of the claims was more than $200 million, and the size of the claims ranged from $1.5 million to $190 million.[41]

Overall, the majority of the large banks in our study see the risks in retirement services as moderate and stable. Nonetheless, some risks are clearly increasing because of the growing complexity of the retirement services market. Increasing complexity and competition are placing

[41] These lawsuits most often relate to claims against the banks' fiduciary responsibilities rather than claims against any particular loss due to operational difficulties.

greater demands on both the technological capabilities of retirement service providers and the risk management skills of those responsible for running retirement services' operations.

G. Large National Banks and the 401(k) Market

This study also focused on the 401(k) market because of the enormous changes in this segment of the retirement services industry. This section summarizes the information gathered concerning large national banks' activities in the 401(k) market.

1. Large National Banks' View of the 401(k) Market

The banks in the study unanimously hold the view that the opportunities in the 401(k) market are growing. All 23 banks responded that they anticipate growing net profits in the 401(k) market.

Banks market 401(k) services to a wide range of firms in both regional and national markets. Most large banks pursue regional markets for their 401(k) services and one-third aim toward the national market. Table 4 (shown earlier) shows that 15 banks focus on regional markets and eight target the national market.

Banks identified their intended markets for retirement services in terms of either participants/assets or company size (sizes were large, middle-sized, and small). Although all of the 22 banks that answered this question sell to middle-sized firms, most also indicated that they market their 401(k) services to firms of at least two different sizes. Only four of the 22 banks concentrate solely on middle-sized firms while nine banks target two sizes and nine banks serve all three sizes. Among the banks that focus on large or small firms, 15 direct their 401(k) services toward small firms and 13 target large firms.

2. Outsourcing and the 401(k) Market

The size of the retirement plan often affects whether a bank outsources some of its 401(k) business. Results from the study suggest that the smaller the plan is, the more likely the bank will be to outsource this business. For each plan/firm size, table 13 shows the number of banks in the study that either provide 401(k) services in-house, outsource these services to a bundled or back-office provider, or have an alliance with a partner. A number of banks indicated that they only outsource particular services, for instance, daily record keeping or statement printing.

Most banks in the study that offer 401(k) services to the small market (on average, less than 300 employees or less than $3 million in assets) use two sources to provide 401(k) services. Roughly half of the banks provide at least some services in-house. Most of these banks also rely on a back-office provider or an alliance partner to supply other services. Only eight banks in this market either provide all services in-house or outsource using a single third-party provider.

The Department of Labor reports in its 1998 study that many employers purchase administration and record keeping services from outside providers. They cite a 1996 study that found less than 5 percent of plans were exclusively administered in-house and only 30 percent by in-house staff supported by vendors.[42]

3. Frequently Outsourced 401(k) Services

Table 14 lists many 401(k) services and the number of banks in the study that outsource each service. Daily record keeping, reporting and distributions, and customer response are the

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[42] U.S. Department of Labor (1998b), section 2.6. The study they cite is a 1996 Spencer and Associates study of 298 401(k) plan sponsors.

Table 13. Current Structure of the 401(k) Business Line

Small Market
(average plan size: less than 303 employees or less than $3 million in assets)

Structure	Responses (n=19)
Services In-House	10
Outsourced to Bundled Provider	4
Outsourced to Back-Office Provider	6
Alliance Partner	6
Other*	5

Middle Market
(average plan size: 363 to 3763 employees or between $4 million and $41 million in assets)

Structure	Responses (n=21)
Services In-House	18
Outsourced to Bundled Provider	1
Outsourced to Back-Office Provider	4
Alliance Partner	7
Other*	5

Large Market
(average plan size: greater than 2683 employees or greater than $39 million in assets)

Structure	Responses (n=17)
Services In-House	11
Outsourced to Bundled Provider	0
Outsourced to Back-Office Provider	3
Alliance Partner	6
Other*	4

Note: A bundled provider refers to a firm that provides a “turnkey” product with both daily valuation and record keeping support. A “back-office” arrangement may be similar, but usually provides only partial support, such as record keeping. “Other” responses indicated outsourcing of particular services, e.g., daily record keeping and statement printing.

Table 14. 401(k) Services That Banks Outsource

Service	Responses (n=18)
Daily Record Keeping	12
Form 5500 Reporting	11
Voice Response	10
Customer Service Representative	10
Form 1099 Production	9
Distributions	9
Compliance/Discrimination Testing	8
Traditional Record Keeping	5
Participant Education Materials	5
Employee Communication Meetings	4
Plan Design	4
Benefits Consulting	3
None	1
Other*	5

Note: "Other" responses include financial planning, participant loans, statement printing, employee communications material, Internet development, partner on large plan record keeping.

services banks outsource most often. Traditional record keeping, employee communication, plan design, and benefits consulting are services that banks outsource less frequently.

The study also asked banks which third-party provider they used for outsourced services. Eighteen banks identified 27 third-party providers, indicating that many banks that outsource use more than one provider. The varied responses made it clear that there is not a dominant third-party provider. The third-party providers banks identified most often were Hewitt Associates and First Data Services, each of which provides 401(k) services to three of the banks in the study.

Large banks frequently participate in alliances with several third-party providers or mutual fund complexes. Nineteen banks identified 54 alliance partners, indicating that, like outsourcing, most banks have alliances with multiple partners. The partners banks identified most often are among the largest mutual fund complexes: Fidelity Investment Services, Janus, Federated Investors, Franklin Templeton, and Putnam. Each of these companies ranked among the top 50 defined contribution service providers in 1997.[43]

4. <u>401(k) Investment Options</u>

Employees investing in 401(k) plans not only decide how much they wish to contribute but also can choose from a number of investment options. These options include money market accounts, government securities, guaranteed investment contracts, bond and equity funds, U.S. equities, equities outside the United States, and employer stock. The large banks in our study offer an average of 10 investment options (a minimum of five options and a maximum of 25). Fifteen of 22 banks indicated that the number of investment options offered varies according to the size of the 401(k) account.[44]

Investment management, including the ability to choose among multiple fund families, is one of the best-in-class standards identified by the Spectrem Group. The average number of investment options offered by banks in the OCC study is slightly higher than the average number

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[43] Ranked by total defined contribution assets. The Spectrem Group compiled the rankings from the 1997 Defined Contribution Directory (Institutional Investor, 1997).

[44] If the definition of investment options expands to include the different mutual funds banks offer to employers, the number of options can rise to 100 or more. On average, employers have 76 options from which to select the participants' menu.

of investment options reported in several other studies of 401(k) plans. Hewitt Associates reported that the 429 plans responding to its survey made an average of eight investment options available to participants. The Department of Labor study reports results from a 1996 Foster/Higgins survey of 743 firms with 401(k) plans. This study also found an average of eight investment options available (although this was more than double the number of options offered in 1990).[45]

Before banks make investment options available to plan participants, banks give employers an even larger number of options from which to choose. Employers then select from these options to determine the menu of investment options that will be available to participants. On average, the large banks in our study give employers 76 options from which to choose. The number of investment choices made available to employers ranged from a minimum of 14 to a maximum of "thousands" (presumably, this bank is able to offer employers the option to choose almost any mutual fund.)[46]

Almost all banks have a formal due diligence process in place for selecting outside mutual funds. The one bank out of 22 that indicated it does not have a process in place noted that its due diligence process is in development. Table 15 lists the possible elements of a due diligence process. Almost all banks consider fund ratings, performance, management history, fee structure, and style analysis in their due diligence process. Slightly more than half of the banks make conference calls to fund managers and analyze the services provided. Six banks also do annual on-site interviews with fund managers.

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[45] Hewitt Associates, 1997, p. 18, and U.S. Department of Labor, 1998b, section 2.3.6.

[46] Some banks may offer employers an extremely wide variety of investment options, but the cost of some options may make them impractical.

The banks in our study offer 401(k) participants similar types of investment options. All banks in the study offer clients equity funds, international funds, bond/income funds, and money market funds. All but one offer lifestyle/asset allocation funds, all but two offer index funds, and 18 of 23 offer guaranteed investment contract funds. .)[47] Other investment vehicles banks offer most frequently include proprietary mutual funds, company stock, publicly traded common stock, collective funds, and self-directed accounts.

Table 15. Elements Incorporated in the Due Diligence Process

Element	Responses (n=22)
Fund Ratings	21
Performance	21
Management History	20
Fee Structure	20
Style analysis	19
Services Provided	13
Conference Calls	13
Annual On-site Interviews	6
Other*	2

Note: “Other” responses listed risk, consistency, and operational interface with record keeping.

[47] A guaranteed investment contract is a debt obligation issued by an insurance company. The guarantee applies to the interest rate paid on the obligation; the principal remains at risk.

IV. Conclusion

Retirement service providers face a variety of risks and competitive challenges. While some large national banks have successfully established themselves as significant providers in this highly competitive market, others have struggled. Some have even exited the business altogether. Others that remain have experienced problems ranging from processing difficulties to financial losses.

The banks in our study appear to be aware of the many risks they face and most have risk management and due diligence processes in place. Banks in the study have also identified shortcomings in their 401(k) services and intend to address them either by building the capability internally, forming alliances, acquiring a third-party provider, or outsourcing some of their operations. None of the banks in the study indicated that they intend to exit the business.

The majority of the large banks in our study believe that retirement services pose only moderate levels of reputation, strategic, compliance, and transaction risks. Nonetheless, nearly one fourth of the banks in the study indicated that strategic, compliance, and transaction risks are increasing over time. Furthermore, banks identified some emerging risks, such as technological risk, fiduciary risk, and competitive risk. According to the banks, these risks have emerged because of greater demands for service, increasing expectations for technological capabilities, and greater competition.

National banks currently are not the dominant players in the defined contribution market. As they attempt to increase their share of this growing market, they face stiff competition from well-established mutual fund complexes, brokerage firms, insurance companies, and other banks. Despite these challenges, the projected growth of the retirement services market may persuade national banks in this line of business to focus on it.

Those national banks that want to compete in the retirement services market must achieve a standard of service established by the top-tier providers. While standards of service constantly evolve in order to meet the demands of the employers and participants, the Spectrem Group identified certain service standards that a provider must achieve in order to meet best-in-class competition. These standards involve employee communication, investment management, trustee services, participant services, and record keeping.

Banks in our study offer many of these services and many intend to expand services in these and several other important areas. Some of the new services banks plan to introduce or expand include Internet access for account information and transactions, paperless loans and distributions, automated processing of self-directed brokerage accounts, financial planning, and participant communication and education.

This study highlights some of the challenges facing national banks as retirement services providers. The shift from defined benefit plans to defined contribution plans has brought dramatic change to the business model for retirements services. This change, along with strong competition, increasing demands for state-of-the-art technology, and narrowing profit margins, creates a challenging environment for banks.

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Appendix A: Questionnaire

Bank Name: ______________________

Total Trust Assets: ________________
Total Bank Assets: ________________

Date Questionnaire Completed:________

Primary Bank Contacts (if any):
____
____
____

Completed by: ____________________
Examiner

1998 COMPARATIVE PRACTICES REVIEW OF LARGE BANK RETIREMENT SERVICES ACTIVITIES

Questionnaire

Strategic Growth Plans

Note: If the bank has prepared a written strategic plan for retirement services, <u>and does not object to its release</u>, please provide a copy of the plan. If management agrees to provide it, let them know that it will be used on a confidential basis and returned to them intact.

1. **What are the most recent managed assets and total assets under administration for the following categories. Also provide "as of" date(s) for the information.**

	Managed Assets (000's)	Total Assets (000's)	"As Of" Date
❑ 401(k) Plan (with or w/o P/S feature)	________	________	________
❑ Profit Sharing (excluding 401(k) feature)	________	________	________
❑ Money Purchase Pension	________	________	________
❑ Other DC Plans - Please List:			
________________________	________	________	________
________________________	________	________	________
❑ Total Qualified DC Plans	________	________	________
❑ Total Nonqualified Plans	________	________	________
❑ Total Defined Benefit Plans	________	________	________
❑ Total Institutional Custody	________	________	________
❑ Other Products - Please List:			
________________________	________	________	________
________________________	________	________	________
❑ IRAs	________	________	________

2. **What primary retirement services or products does the bank currently offer? (For products, please indicate their percentage of total retirement services assets).**

	% of Retirement Services Assets
<u>Products</u>	
☐ 401(k) Plan (with or w/o P/S feature)	_______ %
☐ Profit Sharing (excluding 401(k) feature)	_______ %
☐ Money Purchase Pension	_______ %
☐ Other DC Plans - Please List:	
___________________________	_______ %
___________________________	_______ %
☐ Total Nonqualified Plans	_______ %
☐ Total Defined Benefit Plans	_______ %
☐ Total Institutional Custody	_______ %
☐ Other Products - Please List:	
___________________________	_______ %
___________________________	_______ %
☐ IRAs	_______ %

<u>Services</u>

☐ Record Keeping - Daily
☐ Record Keeping - Traditional
☐ Participant Education Materials
☐ Employee Communication Meetings
☐ Plan Design and Compliance
☐ Benefits Consulting
☐ Voice Response (1-800 Calls)
☐ Client Service Representative (1-800 Calls)
☐ Financial Planning
☐ Form 5500 Filing
☐ Internet Capability:
　☐ Inquiry　☐ Transactions
☐ Self Directed Brokerage Accounts:
　☐ Manual Processing　☐ Fully Automated Processing
☐ Paperless Loans
☐ Paperless Distributions
☐ Compliance Testing:
　☐ §401(k)　☐ §401(m)　☐ §402(g)　☐ §415　☐ §416
☐ Other Services (Please List):
___________________________　______________________________
___________________________　______________________________

3. **What products or services not currently offered does the bank plan to offer in the next year, three years, or five years? Select the single time frame that best reflects the bank's goals or select "NA" if the bank has no plans to offer the product or service.**

	1 Yr	3 Yr	5 Yr	NA
<u>Products</u>				
☐ 401(k) Plan (with or w/o P/S feature)	____	____	____	____
☐ Profit Sharing (excluding 401(k) feature)	____	____	____	____
☐ Money Purchase Pension	____	____	____	____
☐ Other DC Plans - Please List:	____	____	____	____
______________________	____	____	____	____
______________________	____	____	____	____
☐ Nonqualified Plans	____	____	____	____
☐ Defined Benefit Plans	____	____	____	____
☐ Institutional Custody	____	____	____	____
☐ Other Products - Please List:	____	____	____	____
______________________	____	____	____	____
______________________	____	____	____	____
☐ IRAs	____	____	____	____
<u>Services</u>				
☐ Record Keeping - Daily	____	____	____	____
☐ Record Keeping - Traditional	____	____	____	____
☐ Participant Education Materials	____	____	____	____
☐ Employee Communication Meetings	____	____	____	____
☐ Plan Design and Compliance	____	____	____	____
☐ Benefits Consulting	____	____	____	____
☐ Voice Response (1-800 Calls)	____	____	____	____
☐ Client Service Representative(1-800 Calls)	____	____	____	____
☐ Financial Planning	____	____	____	____
☐ Form 5500 Filing	____	____	____	____
☐ Internet Capability:				
☐ Inquiry	____	____	____	____
☐ Transactions	____	____	____	____
☐ Self Directed Brokerage Accounts:				
☐ Manual Processing	____	____	____	____
☐ Fully Automated Processing	____	____	____	____
☐ Paperless Loans	____	____	____	____
☐ Paperless Distributions	____	____	____	____
☐ Compliance Testing	____	____	____	____
☐ Other Services (Please List):				
______________________	____	____	____	____
______________________	____	____	____	____

4. **What products or services currently offered does the bank plan to either expand or contract in the next three to five years?**

	Expand	Contract
<u>Products</u>		
☐ 401(k) Plan (with or w/o P/S feature)	______	______
☐ Profit Sharing (excluding 401(k) feature)	______	______
☐ Money Purchase Pension	______	______
☐ Other DC Plans - Please List:		
__________________________	______	______
__________________________	______	______
☐ Nonqualified Plans	______	______
☐ Defined Benefit Plans	______	______
☐ Institutional Custody	______	______
☐ Other Products - Please List:		
__________________________	______	______
__________________________	______	______
☐ IRAs	______	______
<u>Services</u>		
☐ Record Keeping - Daily	______	_____
☐ Record Keeping - Traditional	______	_____
☐ Participant Education Materials	______	_____
☐ Employee Communication Meetings	______	_____
☐ Plan Design and Compliance	______	_____
☐ Benefits Consulting	______	_____
☐ Voice Response (1-800 Calls)	______	_____
☐ Client Service Representative(1-800 Calls)	______	______
☐ Financial Planning	______	______
☐ Form 5500 Filing	______	______
☐ Internet Capability:		
☐ Inquiry	______	______
☐ Transactions	______	_____
☐ Self Directed Brokerage Accounts:		
☐ Manual Processing	______	_____
☐ Fully Automated Processing	______	______
☐ Paperless Loans	______	_____
☐ Paperless Distributions	______	______
☐ Compliance Testing	______	_____
☐ Other Services (Please List):		
__________________________	______	______
__________________________	______	______

5. How does bank management view opportunity in the 401(k) industry? Answer the question from the organization's perspective (bank and it's affiliates) in terms of anticipated net profits.

- ☐ Growing
- ☐ Flat
- ☐ Declining

6. For year-end 1997, what percentage of asset management income (gross revenue) and bank non-interest income were from retirement products or services?

Note 1: To the extent possible, gross revenue should reflect <u>total compensation</u> to the bank, including administrative or other fees charged directly to trust accounts and participant accounts, asset management fees on mutual funds, 12(b)1 fees, subTA fees, finders fees, and fees paid directly or indirectly to the bank by plan sponsors. If retirement services income is not recorded separately within the institution' business lines/legal entities, please provide the information on a best-efforts basis.

Note 2: This question assumes that retirement services are offered as part of a consolidated asset management division of the bank. If the response is given as a percentage of fiduciary services only, this should be noted.

	Percentage (%)
% of Asset Management Income (or % of Fiduciary Income)	_______
% of Non-Interest Income	_______

7. Over the following time periods, what does management project for percentage income contribution from retirement services?

	1Yr.	3Yr.	5Yr.
% of Asset Management Income (or % of Fiduciary Income)	_______	_______	_______
% of Non-Interest Income	_______	_______	_______

8. **Over the last calendar year, has the bank realized losses or extraordinary charges greater than $1 million associated with retirement services products? If yes, what was the total dollar amount?**

□ Yes $______________
□ No

Note to examiner - if aggregate losses exceed the $1mm threshold, provide summary on any single loss/expense over $500,000.

9. **Which of the following fees does the bank collect? Please provide answers in basis points. If a basis point range is more appropriate (such as for 12b-1 fees, answer accordingly).**

	Defined Benefit	**Defined Contribution (Exclude 401(k))**	**401(k)**
Trustee	________	________	______
Investment Mgmt	________	________	______
Custodial	________	________	______
Transaction	________	________	_______
Participant RK	________	________	_______
Loan Fee	________	________	_______
Base Fee	________	________	_______
Compliance Testing	________	________	_______
Distribution Fees	________	________	_______
Insurance Processing	________	________	_______
Administrative	________	________	______
12b-1	________	________	______
Sub Transfer Agent	________	________	______
Finders Fee	________	________	______
Investment Advisory	________	________	______
Other:			
_______________	________	________	_______
_______________	________	________	_______
_______________	________	________	_______

10. Does the bank rebate fees to 401(k) participants?

☐ Yes ☐ No

If yes, which fees are rebated?

☐ 12b-1
☐ Sub Transfer Fees
☐ Finders Fees
☐ Investment Advisory
☐ Other: ______________________________

11. Are additional retirement services fees being considered? If yes, please list the types of fees being considered.

☐ Yes____
____
____
____
☐ No

12. What is the bank's targeted geographic market for domestic retirement services? Select the single answer that best reflects your market for each product line.

Product	**National**	**Regional (Multi-state)**	**Single State**	**Local**
Defined Benefit				
Defined Contribution (w/o 401(k))				
401(k)				
Nonqualified				
Institutional Custody				
Other:				
Other:				

13. Does the bank plan on offering international retirement services? (Note: this refers to services designed for residents of foreign countries, as opposed to international investment options for domestic customers)

- ☐ Yes
- ☐ No

14. What is the bank's targeted market for retirement services based on either plan participants/plan assets or company size?

Product	**Large Market**	**Middle Market**	**Small Market**
Defined Benefit			
Defined Contribution (w/o 401(k))			
401(k)			
Nonqualified			
Institutional Custody			
Other:			
Other:			

Note: The definition of target market may vary by bank. For this question, we are assuming the definition of large market to be companies with plan participants over 5,000; middle market to be companies with 1,000-5,000 participants and small market to be companies with less than 1,000 participants. If the bank's definition of targeted market is different, please enter their criteria in the spaces above. (For example, institutional custody may be targeted by company size or account assets).

15. What are the bank's strategic goals for retirement services products? Select the bank's top two goals only. Please numerically mark the bank's primary and secondary goal with "1" and "2".

_______ ☐ No Change
_______ ☐ To Broaden Product Mix
_______ ☐ To Add to and Diversity Income Sources
_______ ☐ To Meet Competition
_______ ☐ To Improve Utilization of the Delivery System
_______ ☐ Form Alliance / Partnership
_______ ☐ Acquire Third-Party Provider
_______ ☐ Other:______________________________

16. What does the bank see as competitive advantages for its retirement services line of business (Check all that apply)?

☐ Price
☐ Bank Reputation
☐ Bank Distribution Channels (location)
☐ Automation Capabilities
☐ Superior Customer Service
☐ Related Financial Services (Cross-selling)
☐ Investment Management Services
☐ Customer Relationship Building
☐ Other: ____
____
____

17. What does the bank see as competitive disadvantages or barriers to its goals for retirement services?

- ☐ Management Depth and Experience
- ☐ Regulatory Burden
- ☐ Regulatory / Legal Uncertainty
- ☐ Staffing Issues (locating & retraining)
- ☐ Training Issues
- ☐ Core System Capabilities (automation)
- ☐ Multiple System Interfaces Not Developed (manual processes)
- ☐ Competition
- ☐ Product Array Limited
- ☐ Inexperience with Product/Service
- ☐ Other: ____

____

____

18. Who does the bank view as its primary competition in the retirement services business? Check all that apply. If the bank views some as stronger competition than others, please rank them with 1 through 5, with 1 being the strongest competition.

	Ranking
☐ Mutual Fund Complexes	_____
☐ Insurance Companies	_____
☐ Third-Party Providers / Administrators	_____
☐ Other Banks	_____
☐ Investment Management Firms	_____
☐ Benefit Consulting Firms	_____
☐ Brokerage Firms	_____
☐ Accounting Firms	_____
☐ Other: ____________________	_____

Risk Management Processes

19. **Does the bank have a new product development process for retirement services?**

☐ Yes ☐ No

If yes, who is involved? (Check all that apply)

☐ Board
☐ Committee
☐ Risk Management
☐ Compliance
☐ Audit
☐ Legal
☐ Dedicated Product Development Position
☐ Project/Process Management Department
☐ Business Planning Department
☐ Marketing
☐ Line Business Managers
☐ Operational Support Managers
☐ Automation/System Development Managers
☐ Client Focus Groups
☐ Other: ____

20. **What retirement services related information is included in reports to bank management? (Bank management refers to senior management over retirement services or the closest equivalent in your organization)**

☐ Product sales and trends
☐ Income / Expense
☐ New / Lost business
☐ New product initiatives
☐ Consumer Complaints
☐ Litigation
☐ Audit / Internal Control Issues
☐ Exception Reports
☐ Quality Control
☐ Other: ____

Note: The definition of the term "Quality Control" may vary. This question is intended to address controls over quality of processing support or customer service. Reports may include those on processing volumes, error rates, losses, client complaints, turnaround time frames, system down time, or similar reports.

21. Who sells retirement services products on behalf of the bank?

- ☐ Sales Force Dedicated to Retirement Services
- ☐ General Asset Management Sales Force
- ☐ Brokers
- ☐ Wholesalers
- ☐ Relationship Managers
- ☐ Other: ____

22. How are retirement services sales personnel compensated?

- ☐ Salary Only
- ☐ Salary with Commission
- ☐ Commission Only
- ☐ Incentive Bonus
- ☐ Other: ______________________________________

23. How are retirement services managers compensated?

- ☐ Salary Only
- ☐ Salary with Commission
- ☐ Commission Only
- ☐ Incentive Bonus
- ☐ Other: ______________________________________

24. How are bank employees who make referrals compensated?

- ☐ No Compensation
- ☐ Referral Fee for Lead
- ☐ Referral Fee for Successful Sale
- ☐ Other ______________________________________

25. What risk management techniques / systems does the bank use for retirement service activities? (Check all that apply)

- ☐ Audit
- ☐ Compliance/Risk Management - Asset Management Personnel
- ☐ Compliance/Risk Management - Dedicated Retirement Services
- ☐ Legal - Dedicated Retirement Services
- ☐ Quality Assurance Testing and Reporting
- ☐ Internal Controls
- ☐ Other ______________________________________

26. Has the bank been involved in a lawsuit or significant settlement (significant is $1MM or greater) involving retirement services in the last 5 years?

☐ Yes ☐ No

If yes, has it been certified as a class action?

☐ Yes ☐ No

If yes, please provide dollar amount and dates of litigation/settlement:

☐ Amounts / Dates:____

27. What risks does the bank associate with retirement services products? (Assess risks only as they relate to the retirement services piece of the organization, not for fiduciary services or the bank overall). Indicate the significance of the risks (low, moderate or high) and whether they are decreasing, stable or increasing. If the risk does not relate to retirement services, indicate so by selecting "NA".

☐ Reputation	L M H	D S I	☐	NA
☐ Strategic	L M H	D S I	☐	NA
☐ Compliance	L M H	D S I	☐	NA
☐ Transaction	L M H	D S I	☐	NA
☐ Credit	L M H	D S I	☐	NA
☐ Price	L M H	D S I	☐	NA
☐ Interest Rate	L M H	D S I	☐	NA
☐ Liquidity	L M H	D S I	☐	NA
☐ Foreign Exchange	L M H	D S I	☐	NA
☐ Other______	L M H	D S I		

Explain Reasoning____

28. In management's own words, what are the top three risks that they associate with retirement services?

- ☐ ________________________________
- ☐ ________________________________
- ☐ ________________________________

401 K Services

Note to Examiner: Provide the following information for those banks that currently offer 401(k) products or services. If not offered, then skip to question 42.

29. How is the 401(k) business line currently structured? (A bundled provider refers to a firm that provides a "turnkey" product with both daily valuation and record keeping support. A "back-office" arrangement may be similar, but usually provides only partial support, such as record keeping.)

- ☐ Small Market Define Size ____________
  - ☐ All Services In-House
  - ☐ Outsourced to Bundled Provider
  - ☐ Outsourced to "Back-Office" Provider
  - ☐ Alliance Partner
  - ☐ Other:___________________________

- ☐ Middle Market Define Size ____________
  - ☐ All Services In-House
  - ☐ Outsourced to Bundled Provider
  - ☐ Outsourced to "Back-Office" Provider
  - ☐ Alliance Partner
  - ☐ Other:___________________________

- ☐ Large Market Define Size ____________
  - ☐ All Services In-House
  - ☐ Outsourced to Bundled Provider
  - ☐ Outsourced to "Back-Office" Provider
  - ☐ Alliance Partner
  - ☐ Other:___________________________

30. If the bank outsources 401(k) services, which services are outsourced? Check all that apply.

- ☐ Record Keeping - Daily
- ☐ Record Keeping - Traditional
- ☐ Participant Education Materials
- ☐ Employee Communication Meetings
- ☐ Plan Design
- ☐ Compliance/Discrimination Testing
- ☐ Benefits Consulting
- ☐ Other: ______________________________
- ☐ Voice Response 1-800
- ☐ Customer Service Rep 1-800
- ☐ 5500 Reporting
- ☐ 1099 Production
- ☐ Distributions

31. If the bank outsources 401(k) services, what third-party provider is used? If more than one, check all that apply.

- ☐ Hewitt Associates
- ☐ KPMG Peat Marwick
- ☐ PriceWaterhouse Coopers
- ☐ Frank Russell Company
- ☐ Dreyfus Retirement Services
- ☐ SEI Investments
- ☐ Towers Perrin
- ☐ First Data Services
- ☐ US Pensions
- ☐ Universal Pensions
- ☐ Fidelity Investment Services (BSF)
- ☐ Federated Investors
- ☐ Other (Please List):
  ____
  ____
  ____

32. If the bank currently has an alliance with a third-party provider (administrator) or mutual fund complex, which of the following are used? Check all that apply.

- ☐ Hewitt Associates
- ☐ KPMG Peat Marwick
- ☐ PriceWaterhouse Coopers
- ☐ William M. Mercer, Inc.
- ☐ Frank Russell Company
- ☐ Dreyfus Retirement Services
- ☐ SEI Investments
- ☐ Towers Perrin
- ☐ Fidelity Investments
- ☐ Federated Investors
- ☐ Frank Russell Company
- ☐ Templeton
- ☐ Franklin Templeton
- ☐ Janus
- ☐ Invesco
- ☐ Putnam
- ☐ Warburg Pincus
- ☐ American Century
- ☐ Vanguard Group
- ☐ Other (Please List):
  ____
  ____

33. What investment choices are currently offered to 401(k) clients? (select as many as applicable)

Types of Mutual Funds

- ☐ Equity Funds
- ☐ International Funds
- ☐ Index Funds
- ☐ Lifestyle / Asset Allocation Funds
- ☐ GIC Funds
- ☐ Bond/Income Funds
- ☐ Money Market Funds
- ☐ Other: ______________________________

____

____

Other Vehicles or Investments

- ☐ Proprietary Mutual Funds
- ☐ Nonproprietary Mutual Funds
- ☐ Bank Collective Funds
- ☐ Company Stock
- ☐ Individual GICs
- ☐ Common Stock - Publicly Traded
- ☐ Common Stock - Closely Held
- ☐ Self-Directed Accounts
- ☐ Other: ______________________________

____

____

34. How many investment options are currently offered (on average) to 401(k) participants?

☐ Number of options: ______________

Do the number of options offered vary by size of account?

☐ Yes ☐ No

How many choices are available to sponsors to select the participants' menu?

☐ Number of options: ______________

35. Does the bank have a formal due diligence process for selecting outside mutual funds?

☐ Yes ☐ No

If yes, which elements are incorporated in the bank's process?

☐ Fund Ratings
☐ Performance
☐ Management History
☐ Style Analysis
☐ Fee Structure
☐ Services Provided
☐ Annual On-Site Interviews
☐ Conference Calls on Significant Changes in Fund Operations/Markets
☐ Other: ____________________________________

36. Of the total 401(k) assets provided above, what percentage is processed in a traditional (balance forward) environment and how much in a daily valued environment?

☐ Traditional ______ %
☐ Daily Valued ______ %

37. What does management project these figures to be over the following time frames?

	1 Year	3 Year	5 Year
☐ Traditional	______ %	______ %	______ %
☐ Daily Valued	______ %	______ %	______ %

38. **Has the bank identified capability gaps that would prevent it from achieving its business goals in the 401(k) market? If yes, select those that best capture management's identified gaps. Identify with a "1" and "2" which two are the highest priority gaps:**

- ☐ ____ Daily Valuation
- ☐ ____ Advanced Technology (Capital Investment)
- ☐ ____ Manual Processes (Record Keeping/Fund Transactions)
- ☐ ____ Core Record Keeping System Capability
- ☐ ____ Compliance Testing
- ☐ ____ Brokerage Account Links
- ☐ ____ Comprehensive Fund Offering
- ☐ ____ Plan Design Services
- ☐ ____ Benefits Consulting Services
- ☐ ____ Participant Education / Communication
- ☐ ____ Financial Planning Services
- ☐ ____ Experienced Personnel
- ☐ ____ Investment Track Record
- ☐ ____ Broad Array of Products (Product Development Capabilities)
- ☐ ____ Other: ________________________________

39. How does the bank plan to address the capability gap? Check all that apply.

- ☐ Acquire Third Party Provider
- ☐ Form Alliance/Partnership
- ☐ Build Capabilities Internally
- ☐ Exit the Business
- ☐ Other: ______________________________________

40. Does the bank have formal processes for controlling plan conversions?

☐ Yes ☐ No

If yes, which elements are included? Check all that apply.

☐ Electronic Data Requirement
☐ Data Formatting Standards (Employee Census and Contributions)
☐ Pricing for Nonstandard Plans
☐ Senior Management Review of Exceptional Processing Requirements
☐ Acceptance Standards (Legal Documents, Assets, Prior Reconcilements)
☐ Company Due Diligence
☐ Dedicated, Specialized Conversion Staff
☐ Senior Management Oversight of Process
☐ Other: ______________________________

41. What core record keeping system does the bank use to support 401(k) services?

☐ Omni Plan
☐ Masterworks
☐ Trust Mark
☐ SEI
☐ EBAS
☐ Quantech
☐ DVAL
☐ Other: _________________________

What other automated data processing systems support 401(k)?

☐ Imaging
☐ Work Flow Processing
☐ Proprietary Internally Developed Systems
  ☐ Reconciliation
  ☐ Work Flow
  ☐ Trading Links
  ☐ Other: _______________________
  ____
  ____

42. Please provide any additional comments or information not covered in the questions above.

____

Appendix B: Fee Glossary

Administration/Participant Record Keeping Fee: Fee for providing record keeping and other administrative services for a plan's participants. Record keeping charges are typically annual on a per participant basis covering allocation of contributions, participant statements, and management reports.

Base Fee: Typically an annual flat fee for maintaining a plan's documents, account administration, and employer statements. May include tax reporting and compliance testing.

Compliance Testing Fee: Fee charged for determining whether a plan is in compliance with laws on nondiscrimination.

Conversion Fee: Fee for the service to convert an existing account from a prior provider.

Custodial Fees: Fees for the custody and administration of third-party mutual funds.

Distribution Fee: Charges associated with processing request and issuing a payment for a distribution of plan assets to a participant.

Investment Management Fee: Fee charged for the selection and monitoring of pooled investments such as collective investment funds, third-party mutual funds, and individually managed accounts.

Loan Fees: Fees charged when a loan originates or for processing loan applications.

Participant Education Fees: All costs associated with providing print, video, software, and live instruction to employees about how the plan works, the plan's investment funds, and asset allocation strategies.

Transaction Fees: An account activity fee typically associated with directed investment accounts. The fee is often a per-transaction charge plus a pass-through of all costs charged by outside sources such as securities clearing charges and brokerage commissions.

Trustee Fee: Expenses associated with the service provider holding a plan's assets in trust and the preparation of all documents related to the trusteeship.

12b-1 Fee: A charge to shareholders to cover a mutual fund's shareholder servicing, distribution, and marketing costs.

Wrap Fee: An inclusive fee generally based on the percentage of assets in an investment program, which provides asset allocation, execution of transactions, and other administrative services.