

B E N E F I T S B R I E F

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Brokerage Firms Begin to Reveal the True Extent of Shelving Fees Paid by Mutual Funds

Continuing Securities and Exchange Commission (SEC) scrutiny on undisclosed revenue sharing practices has prompted a number of brokerage firms to begin disclosing the additional compensation they receive for sales of certain fund families. While important to retail shareholders these disclosures are essential to plan sponsors responsible for assessing the “reasonableness” of fees paid by participants through mutual fund expenses. These “soft-dollar” payments represent the discretionary control of plan assets by fiduciaries for the purpose of paying expenses and as such are subject to a strict reasonableness test. [Click here to read coverage on the development in the Wall Street Journal.](#)

Don't Believe the Hype

Princeton Professor Burton Malkiel has struck again with a remarkably well-crafted analysis on the efficiency of markets and inability of professional money managers to add value, net of fees, to passive portfolio indexes and further the inability prospectively to identify managers who will provide excess returns. [Click here to read Professor Malkiel's paper.](#)

The Prudence of Participant Investments

Numerous studies have now been published on the significant performance gap between mutual funds and mutual fund investors. This is a gap that cannot be overcome through superior investment selection and the problem appears to be immune from employee education efforts. Mutual fund investors (participants) are trailing the average mutual fund for 3 reasons:

1. Avoiding risk – Young participants are failing to appreciate the time they have to weather cyclical markets and are allocating too large a percentage of their portfolio to cash and fixed income.
2. Chasing returns – Education efforts have had little demonstrable effect on keeping participants from trading in and out of asset classes in an effort to enhance return. These efforts are consistently leading to underperformance.
3. Failing to rebalance – Participants who have begun to moderate their risk tolerance and allocate to fixed income and cash neglect to rebalance. As their equity allocations appreciate they increase, unknowingly, the volatility of their portfolio and expose it to risk of larger losses.

Fred Reish examines what risks plan sponsors assume in participant directed 401(k) plans and new mechanisms for improving investor performance. [Click here to view the paper.](#)

Plan Design Matters

Frequently the discussion of plan design is focused on identifying opportunities to either manage the total employer cost of funding a retirement plan or on providing better methods for allocating contributions to key employees. Less discussion has been had on what impact core decisions on plan design may have on employee participation rates and thereby the ability of participants to achieve retirement readiness. This paper, by researchers at Harvard and Wharton, addresses design from the perspective of sponsors seeking to increase contributions and participation in their plan. Some of their conclusions...

- Requiring active decisions from participants increases participation
- Employer matching contributions increase participant deferral contributions
- There is a negative correlation between the complexity of the fund universe and the deferral rates of participants
- Availability of defined benefit plans has a negligible impact on 401(k) deferral rates
- Automatic enrollment works
- Sponsors utilizing automatic deferral escalators for electing participants achieve rapid improvements in 401(k) deferral rates
- Employees who are provided some investment discretion contribute at a higher rate than those who are not
- Availability of loan and hardship provisions have a negligible impact on deferral rates
- More investment options cause participants to allocate more heavily away from equities into cash and fixed income
- Participants make naïve investment allocation decisions (i.e. allocating to all funds available in the plan)
- The majority of participants would prefer to have an asset allocation provided them rather than be forced to create one

[Click here to view the paper and data to support their conclusions.](#)

Plan Sponsors Not Providing Adequate Asset Class Coverage to Participants

Recently researchers at New York and Fordham Universities published a paper analyzing the adequacy of asset class coverage in 401(k) plans. In this analysis they concluded that the majority of 401(k) plans do not provide adequate diversification options so participants may create a co-variant optimal portfolio. An additionally surprising discovery in the research was that generally retirement plans trusts paid more for investments than did the retail population as a whole. This discovery provides continuing evidence that investment selection is being adversely affected by industry revenue sharing practices that seek to obscure the fixed costs associated with administration and recordkeeping. [Click here to view the entire paper.](#)



DOL Issues Guidance on Missing Participants

The Department of Labor's Employee Benefit Security Agency (EBSA) recently released a Field Assistance Bulletin (FAB) 2004-02 with guidance on the responsibilities of retirement plan fiduciaries to locate missing and terminated retirement plan participants. This bulleting outlines the steps plan sponsors should take as well as outlining the safe harbor guidelines for automatic rollovers of terminating participants. [Click here to view the FAB.](#)

Vanguard's Bogle Takes Aim at 12b-1 Fees

Mutual fund mavens clashed over marketing fees, with Vanguard founder Jack Bogle again sounding the clarion call of opposition to the industry's so-called 12b-1 regime. The face-off, which as usual pitted Bogle against the fund company trade groups, took place at a midday public forum sponsored by the North American Securities Administrators Association. [Click here to read an article from theStreet.com on the debate.](#)

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