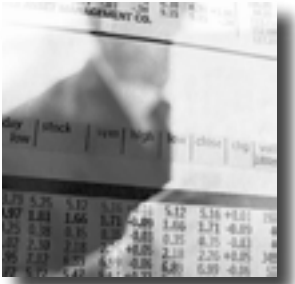




ADMINISTRATORS



HAVING THE WRONG EMPLOYER RETIREMENT PLAN CAN COST YOU HALF OF YOUR RETIREMENT SAVINGS

By Christopher Long, CFP®, NAPFA Registered Financial Advisor™ 1

No, this is not another Enron, WorldCom, or other corporate scandal, but a perfectly legal way that many 401(k) and 403(b) plan advisors and administrators charge excessive fees that can cost the plan participants

by the plan advisor. These fees significantly reduce the overall investment return to the plan participants. In the example above, if the underlying investments in the plan returned 9% and the total fees were 3.08% the

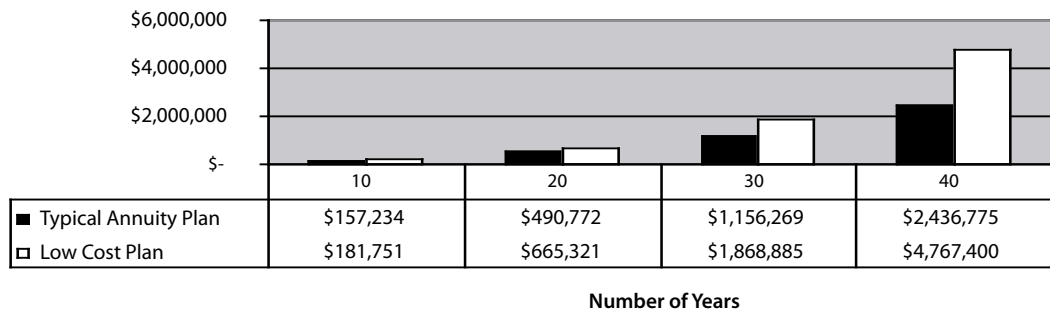


a big chunk of their retirement savings. The real shame is most employers and plan participants never realize what has happened or how much it has cost them.

In 2003, the 403(b) plan at the Sargent Shriver National Center on Poverty Law was typical of high cost plans. It was invested in a variable annuity sponsored by AXA, a large insurance company. Many of the employees suspected the plan might be costing them a lot of money but did not know how.

They were right. According to Morningstar the average variable annuity has an annual fee of 2.08%. This fee does not include any one-time sales charges known as 'loads' of up to 5.75% that many funds in charge, or additional annual fees of up to 1% or more charged

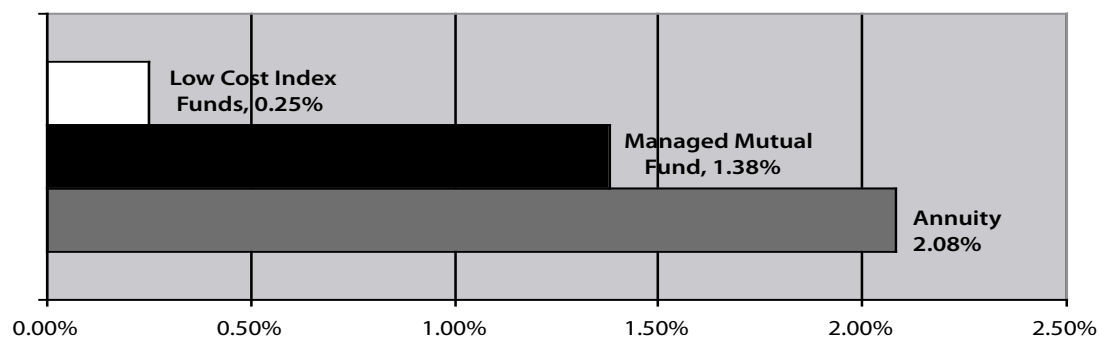
Low Cost Plan vs. Annuity Plan Retirement Savings



participants would receive a return of 5.92%. In addition, the fees would not be disclosed on the statements provided to plan participants. This insidious practice is very common in employer sponsored retirement plans.

What does this mean to the average participant? If she invested \$10,000/year (adjusted for inflation) for 40 years with a 9% return (before fees), she would accumulate approximately \$2,400,000 but pay fees of almost \$875,000, assuming an annual annuity fee of

Mutual Fund Cost Comparison



2.08% and an additional advisor fee of 1%.

Contrast this dismal example with a plan composed of low-cost index funds with an annual fee of 0.25% in which the plan advisor and plan administrator charge a flat fee which is not based on the assets in the plan. For an organization with 100 employees, this could be around \$13,000/year. In this case, the employee would have almost \$4,800,000 and paid total fees of only \$120,000.

In the variable annuity plan the participant would only have accumulated *half* of the retirement assets that she would have in the low-cost index fund plan.

Do annuities offer any advantages in a retirement plan? On its website, the Securities and Exchange Commission (SEC) points out that variable annuities offer no additional benefits as part of an employer sponsored retirement plan. (See, www.sec.gov/investor/pubs/varannty.htm.) If variable annuities are so costly and offer no additional benefits why do so many employer plans have them? The answer is a combination of history and lack of information about their costs. Variable annuities are much more prevalent in 403(b) plans than in 401(k) plans, since in the past, 403(b) plans could only be invested in annuities. Many of these plans are still invested in variable annuities even though employers can now add other options to their plans. Unfortunately, many employers do not understand the costs of their current options or how to add low cost options. Other employers are sold variable annuities for their plans by insurance agents under the guise of being “financial advisors.” They may have an existing relationship with the organization through providing its life or health insurance. They sell the organization a “no-cost” plan since the plan participants usually bear all the costs. What the organization does not often understand is how high those costs will be for the participants in the plan over time, and how much the participants will pay their “financial advisor” over time.

Variable annuities are not the only way a plan can have excessive costs. Many plans offered by payroll providers in conjunction with a major brokerage house, can also have overall annual fees of 2% per year or more. According to the *Wall Street Journal*, the average actively managed mutual fund has a management fees of 1.38% add in financial advisor fees of 0.5—1% and it is easy to get to 2% or more overall. According to the *Los Angeles Times*, a financial advisor for a plan with \$44million in assets was paid \$356,168 approximately 0.8% of the plan’s assets. This was only the advisor’s

fee; it did not include fees paid to the mutual fund companies.

How can you organization avoid a high cost plan? Ask some tough questions. If you ask the right questions you should be able to ferret out most of the hidden costs in a plan.

Q: What are the investment choices in the plan?

A good plan will offer a wide variety of investment choices that allow your employees to build a diversified portfolio. A good plan should offer funds choices covering Large-Cap, Small-Cap, and International stocks, Bonds, and a Cash option (Money Market Fund). Do you have access to a wide variety of funds families? Do you have access to low cost fund families such as Vanguard?

Q: What are the fees for each fund in the plan? Are there any sales loads or surrender charges?

Many funds charge high management fees, greater than 1% per year, and sales loads which can be greater than 5%. Many also have back-end loads which are triggered when a participant transfers assets out of a fund. This is common with annuities. Ask for the prospectus for each of the funds offered and check the management fees. You can find similar information at Morningstar, www.morningstar.com. Also check to see if there are 12-b1 fees. These are fees charged by the fund that are used for advertising or broker compensation.

Q. What are the background and qualifications of the persons offering you the plan? How are they compensated? Are they acting in a fiduciary capacity in all of their dealings with your organization?

Many “financial advisors” are stockbrokers and insurance salespeople who make their money by selling you a plan in much the same way that that a car salesman does and have little or no qualifications to provide investment advice. Check to see if the person is a Certified Financial Planner, which means he or she passed courses covering all the areas of financial planning, have at least three years of experience, and have passed a rigorous two-day 10 hour comprehensive test.

Many advisors are compensated by the mutual funds they sell so they have a strong incentive to recommend those funds whether or not they are a good choice for your plan. A smarter decision would be to work with an advisor who is only compensated directly

© WRONG EMPLOYER RETIREMENT PLAN
Continued from page 15

by your organization or the plan itself. This form of compensation is called Fee-Only™ compensation.² This is not the same as fee-based compensation in which the advisor receives compensation from the client and commissions on the sale of the mutual funds in the plan.

A Fee-Only™ advisor works with your organization in a fiduciary capacity. The advisor must put the interest of the plan ahead of the advisor’s when recommending funds for the plan and advising the plan and its participants. For more information of working with a fiduciary advisor see www.focusonfiduciary.com.

A Fee-Only™ advisor can be compensated in two ways. The advisor might receive a percentage of the assets in the plan. The advantage of this method is that it is easy. The disadvantage is that the advisor’s compensation can grow quickly with the plan’s assets. If the advisor is paid 0.5% of the plan’s assets and the assets grow from \$2 million to \$10 million the advisor’s compensation would rise from \$10,000 to \$50,000.

The second option is to pay a flat retainer fee which is not tied to the assets in the plan, although it may be

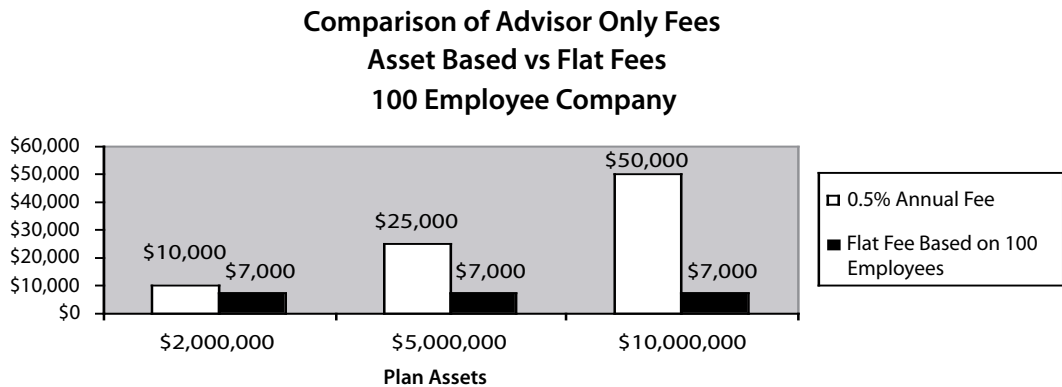
you want to start a new plan or make changes to your existing plan. The plan administrator is the company that handles all of the administrative tasks for the plan: record keeping, providing any necessary legal documents, and insuring the money from payroll deductions is invested correctly. There are many independent plan administrators and your advisor will recommend one to you.

To find a Fee-Only™ advisor, search the website of the National Association of Personal Financial Advisors, www.napfa.org. Most of these advisors work primarily with individual clients but some work with retirement plans as well.

Step 2: If you have an existing plan have your advisor evaluate it.

Your advisor can evaluate the costs of your plan including many of the hidden fees and show you how these fees are affecting your employees’ retirement savings. Your advisor will probably bill your organization on an hourly basis for this work.

Step 3: Decide if you need to make changes to your existing plan.



tied to some other variable as the number of employees. Over the long-run this advisor’s fee will be significantly lower.

What are the steps your organization can take to evaluate your current plan and find plan investments with low costs that provide great retirement investment options for your employees?

Step 1: Seek out a Fee-Only™ advisor for your plan.

This advisor will work with you as a fiduciary. The advisor will help you find a plan administrator should

Your advisor can explain pros and cons of making changes to the investment selections in your plan. In some cases your current plan may have many good low-cost investment choices and a few poor ones. All you may need is for the advisor

to educate your employees on the investment options in the plan and suggest which may be appropriate for them.

Should you decide to make changes to the investments available in your plan or change the type of plan you have (e.g. 403(b) to a 401(k)) your advisor can explain all of the pros and cons of the options available. Should your plan require a new plan administrator, your advisor should be able to recommend one. Your advisor and plan administrator will work together as a team to implement the changes.

under Wilkes' command as they traversed some 87,000 miles of often treacherous waters. But the author has also devoted a substantial part of this book to examining the question that most interested me: *How can it be that such an enormously successful expedition and leader are virtually unknown? Why have Wilkes' exploits not won popular acclaim?* The answer is a pretty simple one, and provides a good reason to consider the leadership lessons that may be found in this book. As described in a review written by Timothy Brown, Philbrick's work painstakingly details how "Wilkes' undaunted resolve to complete his mission was fueled by vainglory. Profoundly insecure, he imagined that his officer corps was either incompetent or insubordinate, and meted out arbitrary punishments. [He] commonly resorted to the lash...in excess of naval standards. After four years of such neurotic tyranny, Wilkes' crew and officers thoroughly hated him. Instead of returning to New York in 1842 to parades and praise, Wilkes was tried for his abuses in military

court..." Thus, in the end, newspaper coverage of the trials blemished Wilkes' reputation and career, and skewed the public's understanding of the expedition. As a result, its many notable accomplishments have been largely if not totally obscured.



There is no doubt in my mind but that *every* legal aid manager and director could benefit by reading (or listening on tape to) these two books and contrasting the nature and ultimate effects of the starkly different leadership styles. However, I especially recommend them to those of you who, like myself, really enjoy histories and biographies but more or less tolerate and struggle through management articles and books. As to the order of reading/listening, the choice of course is yours. So what do *you* prefer first — the good example or the bad?

© WRONG EMPLOYER RETIREMENT PLAN
Continued from page 16

Step 4: Explain any proposed changes you plan to make to the plan to your employees.

It is important that your employees understand any changes you are planning to make and how it will benefit them. You may wish to have an "open house" meeting where your advisor can explain the proposed changes and their benefits and answer any employee questions.

Step 5: Provide ongoing education to your employees

It is critical that you provide ongoing education to your employees about their plan investments. Although many online products education products exist, many employees may respond more favorably to a short conversation with your plan advisor. If your employees make good investment selections initially, then only an occasional check-up is necessary. New employees can be handled through new employee orientation meetings and short individual meetings with your advisor.

By working with a Fee-Only™ fiduciary advisor when making decisions about your organizations retirement plan, you will avoid costly mistakes and significantly increase your employees' retirement assets. That may be one of the most important things you can do for them.

- 1 Chris Long CFP®, MBA, NAPFA Registered Financial Advisor, Long & Associates LLC, may be reached at 312-373-9265, Fax 312-803-0948, www.longfinancialplanning.com, chris@longfinancialplanning.com.
- 2 The term Fee-Only™ refers to how the advisor is compensated. Most financial advisors are compensated by third parties (e.g. mutual fund companies, insurance companies) by commissions for selling the company's mutual funds or insurance products. This creates a conflict of interest between the advisor and the client who thinks she is getting unbiased advice.

The term Fee-Only™ was trademarked by the National Association of Personal Financial Advisors (NAPFA). NAPFA Advisors are all Fee-Only™ and are held to a fiduciary standard when working with their clients. Less than 1% of all financial advisors are held to this standard.

Because of this fiduciary standard, NAPFA advisors are held in the highest esteem by the public and the press. They have been endorsed in the *Wall Street Journal*, *Newsweek*, and other publications.

The author is a NAPFA member, and on the Midwest Regional and National Boards of the organization. One can find out more about NAPFA at www.napfa.org.