A job for professionals

New 401(k) option offers portfolio management for a price

By Bruce Shutan

Between the Bear Market and Enron-style retirement plan meltdowns, legions of working Americans would like nothing better than hand over management of their 401(k)s to experts who won't charge an exorbitant fee.

That day has arrived. Market volatility spawned so-called "professionally managed" options, also known as lifestyle or age-based funds, whose asset mix gradually changes over time to reflect a participant's age and risk level.

The approach appears to be picking up steam with employees who no longer have the time, desire or skills to actively manage their portfolios. In annual surveys of nearly 950 plan sponsors, the Profit Sharing/401(k) Council of America found that 33% of the respondents offered such an option in 2001, up from 22% in 2000.

'Exciting' development

"This is one of the most exciting products I've been involved with in 30 years as a registered investment advisor," enthuses Marshall Schield, president and founder of Schield Management Company in Littleton, Colo.

Schield is one of four registered investment advisors to offer professional third-party management of 401(k)s through Nationwide The Best of America Group Pension Series Program, which targets small and midsize businesses. Nine models are used to customize participant portfolios to fit each individual's risk tolerance, time horizon, financial assets and continuing economic and market factors.

The program was launched in the fall of 2001 on a limited basis and rolled out across the U.S. last June. The company manages about 150 such plans and another 50 in various stages of enrollment.

The professionally managed funds do not cost employers anything (they're among Nationwide's roughly 500 mutual fund options). About 80% of participants who listen to the sales pitch sign up for the service and agree to pay the 1.5% fee, according to Schield. He calls the participation rate a reflection of "how frustrated participants are with managing their accounts."

Mark Veerkamp, CFO of Shambaugh & Sons LP in Fort Wayne, Ind., began investigating professionally managed funds after one too many employees asked for his asset-allocation recommendations.

The engineering firm turned to Schield Management, which held educational seminars at eight company locations to explain the new option – one of 30 401(k) choices. Of nearly 400 participants, 159 have signed up since December.

The new accounts appeal to a variety of employees – from truck drivers to engineers. "A number of them were frustrated with the results of the past year or two and fearful of what the future might hold for their accounts," reports Veerkamp, whose responsibilities include HR and benefits administration.

Expansion of choice

Adding a professionally managed fund option "lets us expand investment choices to help meet the needs of our employees who may be unable or unwilling to commit the time required to make regular investment decisions," according to Thomas Z. Reicher, head of San Francisco-based Cooley Godward, LLP's Compensation & Benefits Group and chair of the law firm's Retirement Plan Committee.

He arrived at this conclusion after chatting with participants, including many lawyers who didn't have a clue about the best way to manage their accounts. "As much education as we've given them," Reicher reports, "they didn't feel in complete control."

Of the roughly 1,500 participants in Cooley Godward's 401(k) plan, 446 have signed up for a new Charles Schwab offering since October. Reicher believes participation will increase as more people learn about the concept.

The operating expense ratio for Schwab's professionally managed funds is 89 basis points. "This isn't layered on top of other fund fees," explains Ben Brigeman, senior vice president for Charles Schwab Corporate Services in Richfield, Ohio. Similar funds offered by Barclays are 85 basis points, and with just four extra basis points he says "you get professional money management, the same quarterly rebalancing and annual asset allocation, which is a good deal. You also don't have one proprietary fund house."

Nearly 45 plan sponsors have signed up for Schwab's new offering, which launched nationally in February. "We're seeing quite a bit of interest and a good reception in the marketplace," says Brigeman, who boldly predicts that most 401(k) plans eventually will adopt this approach.

Schwab Retirement Solutions includes four professionally managed retirement trust funds that tie asset-allocation strategies to a participant's approximate retirement year (2010, 2020, 2030 or 2040). The investment mix and asset allocation are adjusted so that the portfolio grows more conservative over time.

Major institutional players such as Goldman Sachs, Invesco, PIMCO and Dodge & Cox manage the underlying funds in each asset class. Dual layers of oversight are provided by Schwab's internal investment committee as well as consultant Callan Associates, Inc. Schwab won't hesitate to "pull the trigger on poor-performing money managers and replace them with high-quality institutional managers," Brigeman says.

In praise of restrictions

Ted Benna, creator of the 401(k) plan and president of The 401(k) Association in Jersey Shore, Pa., recently moved a client to Schwab because of this approach as well as the provider's reputation ($88 billion in retirement plan assets are now under management).

But he's disappointed that the service provider may not be able to save some participants from themselves. "Schwab's record keeping system wouldn't support what we wanted to do, which was limit participants to only one of these funds so they wouldn't treat them as just another of their 18 fund selections from which to choose," he reports. "It defeats the logic of this type of fund structure and undermines the goal of having 100% invested in one of these funds or none at all."

While a major supporter of participant choice, Benna is adamant about the equal importance of installing plan design controls to help relatively uninformed participants achieve better long-term results. He cites as another example his client's decision to limit

investment activity in its self-directed account to trading only mutual funds and not individual stocks in light of high-profile 401(k) debacles at Enron, WorldCom and others.

Despite the philosophical difference over Schwab's new fund offerings, Benna praises the service provider for closely monitoring manager performance to prevent style drift and its willingness to replace poor performers.

While agreeing in principal with Benna's argument that it makes sense for most participants who use professionally managed funds to adopt only that approach, Brigeman explains that "there would be inherent philosophical and potentially even fiduciary issues on limiting participants to investing in only one component."

For example, he says there are times when participants should be using both the core set of mutual funds in their plan *and* a self-directed brokerage account if certain style categories aren't offered.

Professional performance

While it's too early for a rush to judgment on fund performance, certain results may be somewhat encouraging. While the S&P 500 Index was down roughly 24% within the past year, Schield Management was down about 11%, even after a 1.5% management fee. "Part of our goal is to reduce losses during the bear market and increase gains during the bull market," Schield says. "It's been ugly out there."

The firm is fast approaching $100 million in assets under management with this product and expects that it could reach at least the $300 million to $400 million mark by yearend, which he says could turn out to be a conservative estimate. "We're talking to one plan with $300 million and another with more than 45,000 participants," he reports.

Hardly anyone can resist knowing if plan participants or the professionals ultimately will prevail. "Only time will tell whether this particular series of funds and the managers who've been chosen will do better than participants who use the tools we provide them outside of these funds," Cooley Godward's Reicher says. "At least it's a movement away from blindly allocating to all equity or money-market funds."

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Employee Benefit News

April 15, 2003