Are you adding value to your client's defined contribution plan, or just cost?

When most people think about their investment returns, they think in terms of maximizing gains by beating the market or being a part of the latest trend or headline in investing. Clearly gains are the starting point of return, but over time, beating the market index return may not necessarily be the most important factor in maximizing your return. According to numerous studies if individual investors would concentrate on achieving the market rate of return, coupled with minimizing their costs and expenses to do so, they would greatly increase their returns and ending balance available to fund their retirement.

The Chicago-based research firm Dalbar found that the average investor has underperformed the market, each and every year, since it began compiling data in 1990. The S&P 500 index returned an average 9.14 per cent over the past 20 years, while the average investor earned only 3.83 per cent[1]. Iindividual investors are not only failing to beat the market, they are failing to beat inflation and the loss of purchasing power is a real loss. The reason for this can be found in a recent study conducted by Longboard Asset Management who took a close look at the returns of 3,000 stocks from 1983 to 2007[2]. They showed how the odds are stacked against the investor who tries to pick their own stocks as only 25% of stocks were responsible for all the market's gains and 64% of stocks underperformed their index. In other words, chances are great that you're picking the wrong stocks.

But what about active managers of mutual funds, how were their returns? According to an academic study by Shaun Pfeiffer and Harold Evensky[3], not well. The study which examined 20 years of mutual fund performance data, tracking expansions and recessions both separately and collectively found that actively managed funds' average underperformance in comparison to an index, net of fees, to be about 9% over a 10-year period. According to a recent Money magazine article[4], even when actively managed funds beat their index by 1%, their fees for active management equaled 140% of the out performance. The case for active management is further weakened by the wide variance among actively managed portfolios and the lack of persistence across business cycles. In other words today's winner can be tomorrow's dog. Kenneth R. French of Dartmouth in a paper *The Cost of Active Investing* found the typical investor would have increased their average annual return by 67 (0.67%) basis points over the1980 to 2006 period if they switched to a passive market portfolio. Doesn't sound like much? Over the 26 year period 67 basis points difference in annual return will make over an 18% difference in ending balance!

How does all this relate to defined contribution plans and your client? Many plan sponsors think they are meeting the fiduciary obligations imposed on them by ERISA by merely offering a wide variety of

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[1] The Globe and Mail Dec. 02, 2012, Outsmarting the market: Don't be a sucker

[2] Business Insider Mar. 22, 2013, CHART OF THE DAY: Proof That You Stink At Investing

[3] Advisor One October 18, 2012 No Alpha: Evensky's New Research Delivers Fresh Blow to Actively Managed Funds

[4] Money May 2013 How much does your mutual fund manage cost you? Wall Street veteran Charles Ellis says it is a lot money than you think

investment options and self directed accounts. Many plans are set up so that the plan pays for the costs of investing and not the plan sponsor so there is little immediate incentive to monitor costs. Many plan sponsors either do not know they have an obligation under ERISA to review the plan expense for reasonableness or they lacked the ability to do so as most of these costs were hidden. In July of 2012 this all changed. Now all plan costs must be fully disclosed. The age of transparency in fees has begun.

For many CPA's their involvement with the clients plan is limited to an annual audit if the plan is over 100 employees, they do not view the defined contribution plan as a cost center and important employee resource where they can and should add value for the client. It can also be an area of potential liability for failing to meet all of the fiduciary obligations imposed by ERISA. The failure to meet these fiduciary obligations can result in Department of Labor fines and/or future law suits from participants or their heirs once they discover their balance is inadequate to retire on. This is an emerging area of litigation.

What should you do as a CPA? At a bare minimum discuss this area with your client and make sure they understand all of their fiduciary obligations under ERISA. Discuss with your clients the fact the so called "guarantees of fiduciary obligation" some investment providers give is not worth much in the final analysis as they are only providing advice to the sponsor not investment management and this will not relieve your sponsor of their fiduciary obligations or potential liabilities. Make sure your client understands the effects of small differences in annual expenses can have when compounded over time on the final balance. Make sure they understand that even if the plan is paying the fees and not the sponsor, excess fees it can still have a potential long range cost to them as they still have an obligation under ERISA to justify the reasonableness of fees and expenses in relation to the services provided. Fees and costs can no longer be ignored just because the sponsors are not paying them as they can have a large affect on ending balances and hence your clients potential liability for failing to meet their fiduciary obligations.

At Financial Wings (www.myfinancialwings.com), as a Licensed Investment Advisor, we go a step further. We start by reviewing the current plan, understanding ALL of its costs and the performance achieved and comparing it to plans offered by competitors (by SIC code or name) and nationally to all similarly sized plans. We call this benchmarking and believe this fulfills your client's annual review obligation. If we find the costs can be reduced we recommend alternative providers. We strongly believe all plans should offer professionally constructed and managed portfolios of investments as an investment choice for participants. We will offer two types of investments, one based on low cost mutual funds such as Vanguard and the other on exchange traded funds (ETF), i.e. index funds. These are organized into 5 types of portfolios for each (10 total) varying by risk profile the participant selects. Since these portfolios' have been professionally constructed and are being managed, we will provide a guarantee in writing to assume the plans fiduciary obligation thus the sponsor is relieved of their fiduciary obligations under section 3 (38) of ERSIA . We meet with the participants at least annually to advise on their investment options and the appropriateness of their choices. At Financial Wings we believe in fee transparency, all fees will be fully disclosed so everyone will clearly see who is being paid by whom and what they are paid. Financial Wings is an independent advisor, we are not affiliated with any broker. We only work for our clients.

Financial Wings would like to be part of your client service team. Calls us on a no fee or obligation basis and see if we can be a part of your effort to bring value to your clients defined contribution plan.

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