THE STATE'S BUSINESS NEWS AUTHORITY.
Arkansas Business

SPOTLIGHT: Banking & Finance

UPDATED DAILY: ArkansasBusiness.com

VOL. 34, NO. 3 JANUARY 16-22, 2017 $1.50

Are 401(k) Costs Fair? Firms Can Analyze Fees

By Gwen Moritz
GMoritz@ABPG.com

The suspicion that one's 401(k) plan might be costing more in fees than necessary has taken root in the American consciousness. It was the subject of an expose by the PBS documentary series "Frontline" in 2013, a groundbreaking U.S. Supreme Court ruling in 2015 and even a profanity-laden episode of John Oliver's "Last Week Tonight" last June.

It's been four and a half years since the U.S. Department of Labor required all providers who get a piece of the retirement pie to reveal their fees, both direct and indirect. That accelerated downward pressure on fees, now averaging less than 0.7 percent, as 401(k)s and similar plans have become the dominant retirement vehicle for private-sector employees.

But disclosure is hardly the same as transparency when the fees are disclosed in different places. Even knowing the total cost is not the same as knowing whether the price is fair. And that matters, since plan sponsors — employers offering 401(k) plans — can face legal consequences if they allow their employees to be overcharged.

Two firms in central Arkansas, CFO Network of North Little Rock and Fiduciary Wealth Management of Little Rock, have in recent months begun offering 401(k) fee analysis for companies that want to make sure that their plan fees are reasonable.

"There are so many cracks and crevices in which fees can hide," said Ed Mahaffy, principal owner of ClientFirst Wealth Management in Little Rock, who formed Fiduciary Wealth Management with Rocklin "Roc" Senavinin last year.

Rocklin Senavinin is President of Fiduciary Wealth Management of Little Rock.

"When we do the analysis, it's amazing what some people are paying, and they have no idea," Senavinin said.

CFO Network was paid by Arkansas Business Publishing Group to analyze its retirement plan in 2016. The service is a sideline to CFO Network's primary business as an outsourced provider of accounting and consulting services, and it grew out of Managing Director Allen Engstrom's concern about his own company's 401(k) costs.

"This started with me looking at my own [account] statement as a member of the plan," Engstrom said last week.

Plan advisers charge a fixed percentage of the assets in each account, and they may also get a trading commission, opaquely referred to as an "override," on contributions invested in the actively managed mutual funds that they choose or recommend as investment options within the plan.

The percentages charged for advisory fees and the fees associated with mutual funds within the plan seem small, Engstrom said, but a rough spreadsheet analysis told him that an employee saving for 35 years or more could end up with an account balance that had been reduced by more than a third because of fees.

For a hypothetical employee whose retirement account after 35 years would grow to $1 million without any fees, the cost of the advice and fund management can be "shocking," Enstrom said.

"If you told Mary Smith, 'You have to write a check for $380,000 for all the advice they've given you over the years,' you'd say, 'No way.'"

You might also get sued. As plan sponsors, employers have a fiduciary duty to employees, even if some of the plan advisers may not.

And the fiduciary has to stay on top of the details. In its 2015 Tibble v. Edison International decision, the U.S. Supreme Court ruled unanimously that the trustees of a retirement fund have a continuing duty to monitor the suitability of the investments. In this case, the fund was a 401(k) and the suitability question concerned management fees on mutual funds.

Engstrom gave Senior Analyst Matt Duckworth the assignment of ferreting out the fees.

They are all disclosed, "but it's buried in an ocean of 8-point type," Engstrom said. Even a motivated plan member has no one to consult except the adviser, who may have a vested interest in making it confusing.

When CFO Network's previous plan adviser learned that Engstrom and Duckworth were crunching the numbers, "they tried to be proactive by saying we were on a list of clients eligible for a reduction in fees," Engstrom said.

Transparency is effective: In 2012, many providers voluntarily slashed their fees in the run-up to the DOL disclosure deadline. Mahaffy, with Fiduciary Wealth Management, said average fees have come down by a third since 2000.

While a 401(k) plan will never be free, Engstrom said CFO Network ultimately changed providers, and its plan now features low-cost index funds rather than the higher priced managed funds. And instead of projecting a reduction in an account's balance of 38 percent after fees and lost earnings, the reduction is about 5 percent — $50,000 rather than the $380,000 from Mary Smith's hypothetical account.

Passive Savings

Duckworth at CFO Network and Senavinin at Fiduciary Wealth Management have both developed processes for identifying and analyzing total fees being charged in existing plans, and their analysis typically costs $5,000 or less.

"With one meeting taking an hour, I can usually have the results back within two weeks," Senavinin said. "It's a very transparent, reader-friendly analysis: Here's what I have and here's everything I'm paying and here's a benchmark."

(Senavinin also offers wealth management services to individuals and trusts, and he was recognized as an *Arkansas Business* 40 Under 40 honoree in 2014, when he was a vice president with Charles Schwab & Co. in Little Rock.)

Another thing CFO Network and Fiduciary Wealth Management have in common is a fondness for low-cost passive investments — index funds — rather than funds that are actively managed by professional stock pickers.

Engstrom, at CFO Network, said he became a believer in index funds when he was studying for his MBA at the University of Texas at Austin. "I had these Ph.D. finance professors who were saying they can't beat the market. If you accept that you can't beat the market, that leads you down the path of passive investing," he said.

And that's becoming a well-traveled path, Mahaffy said. Late last month, *Barron's* reported that nearly $1 trillion flowed into passive funds during the past three years while almost $500 billion has flowed out of active U.S. funds during the same period.

Barron's is actually suggesting that investors consider more actively managed funds in 2017, but Mahaffy has not changed his mind.

"Their performance is hideous," he said. "Eighty-six percent underperform the passive index funds." ■

"With one meeting taking an hour, I can usually have the results back within two weeks. It's a very transparent, reader-friendly analysis: Here's what I have and here's everything I'm paying and here's a benchmark."

[ROCKLIN SENAVININ, PRESIDENT, FIDUCIARY WEALTH MANAGEMENT OF LITTLE ROCK]