decimal, inc.

One Sutter Street, 6th Floor, San Francisco, CA 94104
p: 415.477.8800 f: 415.477.8801

www.theonline401k.com

Decimal in the News

Playing with the Big Boys

Online 401 (k) platforms are bringing low-cost, corporate-style retirement plans to small businesses

BLOOMBERG WEALTH MANAGER
April 2005

By David J. Drucker

Few advisers specialize in serving the 401(k) plan needs of their clients who own small businesses. Designing and installing affordable plans, after all are generally regarded as service-intensive activities that don't compensate advisers very well. To properly set up a 401(k) plan, an adviser must first select a mix of investments that will enable plan participants to construct an appropriate asset allocation. He must choose a custodian and make arrangements to handle the plan's investment policy statement, legal compliance, record keeping, tax filings, and other administrative tasks, either himself or through a third-party administrator (TPA). And he must help the client sponsoring the plan educate employees about investment options so they make reasonable decisions.

Despite the enormity of the task, however, there's good reason for advisers to get involved. You may be able to help your clients reduce administrative costs and gain access to more-affordable investments. Small-business owners and their employees tend to pay more for their 401(k) plans than large companies do. Participants in 50-person plans pay an average 1.4 percent of assets in annual fees, whereas those in 1,000-person plans pay 1.17 percent, according to David Huntley, a principal with HR Investment Consultants, a Baltimore consulting firm. "In some cases, small-plan participants pay more than 3 percent," Huntley adds.

That's partly because smaller companies don't have as many plan participants sharing administrative costs, but it's also because of the available investment mix. Rather than buying a plan offering low-cost mutual funds, as many large firms do, small businesses often end up with plans that use group annuities, which have fund expenses up to 3 percent and other hidden costs, says Steven Podnos, principal of Wealth Care, an independent financial-advisory firm in Merritt Island, Fla. Although annuity-based plans are also potentially more lucrative for advisers, most agree that placing clients in low-cost plans pays off. Generally, "401(k) plans aren't a target [service] for us, but they come up because the clients we work with are often entrepreneurs and want us to handle everything, including their retirement plans," says Howard Goldson, principal of Pinnacle Wealth Strategies in West Coxsackie, N.Y., who has a background in employee benefits. "So setting up 401(k) plans is more than an incidental service."

And the advent of a number of online 401(k) service providers during the past decade has simplified the process for advisers, allowing them to earn a reasonable wage while making retirement plans more affordable for their clients. BLOOMBERG WEALTH MANAGER recently surveyed a sampling of such providers as well as some services offered by the large custodians. Online 401(k) platforms and third-party administrators such as Street Smart 401k (**www.streetsmart401k.com**), The Online 401K (**www.theonline401k.com**), BenefitStreet (**401k.benefitstreet.com**), and 401kBrokers.com (**www.401kbrokers.com**) offer various mixes of services, including investment selection, custodial, and administrative. Some offer all these services, either independently or within a prearranged network, whereas others specialize.

Choosing the best for your practice depends largely on which tasks you are comfortable performing and which you'd prefer to outsource.

Street Smart 401K, in Toledo, Ohio, which launched its online platform for registered investment advisers (RIAs) in August 2003, provides all the resources necessary for setting up and maintaining small-business 401(k) plans. The brainchild of Darrin Farrow and Peter Kneip, Street Smart gives plan participants—that is, your client's employees— access to eight model investment portfolios developed with the help of Nobel laureate Daniel Kahneman. The firm relies on ExpertPlan (**www.expertplan.com**), a third-party provider in East Windsor, N.J., to provide Web-based administrative services. Advisers can request plan proposals online and have access to marketing and educational tools, including a sample questionnaire for investors and a fee schedule.

Investors are given a certain amount of control over their accounts through online enrollment as well as access to account summaries and statements, loan and distribution requests, and educational materials. Whenever participants want to make investment selections—either at the onset or later—they are guided through Street Smart's proprietary, online Portfolio Builder questionnaire. "Most plan participants don't allocate their contributions properly," says Farrow. "They chase sectors, they panic, and they get out of the market at the wrong time." The questionnaire confronts plan participants with questions about their investment attitudes, time horizon, and long-term goals and objectives. "Running through the questionnaire, a panicked participant is reassured that his original objectives are still sound, and he stays invested as he should be," says Kheip.

The questionnaire and Street Smart's other technology significantly reduce the workload for advisers, advocates say. Rather than spend a great deal of time teaching plan participants basic investment concepts, an adviser can simply teach the investors how to use the questionnaire, which provides much of that education. "Before using Street Smart, it usually would take a couple of us meeting half a day with a small plan's employees as well as follow-up visits to ensure the plan was installed correctly," says Goldson, a Street Smart disciple. "Now we go out, generate a proposal, and show the participants how to navigate the Street Smart Website. We can have them up and running in several hours. And the questionnaire should keep the participants properly invested rather than engaging in knee-jerk reactions [to market volatility]."

Critics say that Street Smart is too expensive for the average small-business client. But Kneip counters that expenses depend greatly on which platform the adviser uses—Street Smart has separate platforms for RIAs and broker-dealer representatives— and how much the adviser charges for his own services. Most RIAs charge their usual fees—typically between 50 and 70 basis points—for their services, say Kneip and others. (Federal authorities have been investigating how advisers are compensated for their work with 401(k) plans. For some insight into those proceedings, see "Show and Tell," March.) Underlying fund expenses for the model portfolios range between 1.02 percent and 1.10 percent on the RIA platform and between 1.10 percent and 1.47 percent on the commission-based platform. Beyond that, "Street Smart gets 50 basis points on all [participant accounts] to compensate us for developing and maintaining the model portfolios," says Kneip. In addition, setup fees, annual administrative fees, and annual per-participant flat fees are collected to pay ExpertPlan for the administrative services it provides. New plans with less than $4 million in assets lay a flat setup fee of $750; new plans with $4 million or more pay no setup fee. Plans with less than $8 million are assessed an annual administrative fee of $750. Setup and administrative fees are typically paid by the business owner, or plan sponsor. Participants in plans with less than $4 million pay an annual flat fee of $30 and those in plans with $4 million to $8 million pay $20 a year. Sponsors and participants of plans with more than $8 million pay no setup, administrative, or annual flat fees.

Mickey Cargile of Cargile Investments in Midland, Tex., says converting to Street Smart has paid off well for his clients, though he adds that the platform hasn't provided many advantages to his practice. Because we're very hands-on, I don't see a decrease in the amount of time we spend on a plan," says Cargile, who has implemented 401(k) plans for clients for more than 20 years. "And this type of plan is less profitable [for advisers] than a group annuity 401(k) plan would be—but it's a better product. If you stay ahead of the technology curve, you can deliver something of greater value to your client."

The Online 401K, launched in August 1999 by former adviser Chad Parks, also uses Internet technology to make retirement plans easier for advisers to handle and cheaper for small-business owners and their employees. Through its Website, The Online 401K provides plan documents as well as participant enrollment and education. Other online services include administration, daily valuation record keeping and trading, and live customer support. "I wanted something for my clients that was fully bundled, with administration built in, multiple fund families available, but no commission structure," says Parks, chief ex ecutive officer of Decimal in San Francisco, The Online 401K's parent company.

"Being able to administer and do every thing online, and allowing employees to log in and change allocations, is wonderful," says Joel Javer, an adviser with Sharkey, Howes & Javer, in Denver, who uses The Online 401K to operate plans for his clients. "Once the administrator gets everything set up online and conducts an enrollment meeting for the employees, things become pretty much automatic."

Plan sponsors and participants have access to a selection of 35 mutual funds, which Seymour Moskowitz, an adviser in Indian Wells, Calif., says "covers all asset categories and investment styles." Before working with The Online 401K, Moskowitz used to put together 401(k) plans on his own. He would gather up the best 10 or 15 funds he could find, select a cost-effective custodian like Schwab or Fidelity, and assemble all the pieces. He says the ready-made list is one of the advantages of using The Online 401K.

Javer, however, views the list as too limited. "It has 35 mutual funds you can buy on Charles Schwab & Co.'s NTF (no transaction fee) platform, most of which I wasn't familiar with," he says, "but I got a private deal, so my clients have six funds [of my choosing]." In fact, says Parks, any adviser who is dissatisfied with the list can override it. They can then build their own list from some 2,000 mutual funds offered through Schwab, which The Online 401K uses as its custodian. For anyone still dissatisfied, "we can also offer Schwab's discount brokerage window, which gives participants access to virtually any mutual fund, stock, or bond; says Parks, but additional fees are charged for that service.

Unlike Street Smart, The Online 401K doesn't charge asset-based fees for its services. Small-business owner clients launching a new plan are assessed a flat $495 setup fee, and thereafter a flat monthly fee of $155 for companies with 2 to 10 employees and $185 for companies with 11 to 25 employees. Businesses are then assessed an extra $5 a month for each increment of five additional employees. Parks says. One caveat concerning expenses: "It's very much designed for brand new plans that can be set up easily,' says Javer. "However, we have many clients with existing plans who can't justify the $1,000 it would cost to convert their plan documents to move to The Online 401K." No other fees are charged to plan sponsors or participants except the underlying fund expenses. Advisers who use the platform must work out their own fees with their clients.

Another difference between The Online 401K and, Street Smart, acknowledges Parks, is that The Online 401K's online education is not as sophisticated, although he adds that it's being developed from simple online text to a more interactive process. The adviser who sets up the plan is expected to provide participants with direct guidance on investment choices. Does Moskowitz act as a personal adviser to each of his clients' plan participants? "No, but I monitor the overall allocations of a small-business client. If the overall plan is being invested too aggressively or too conservatively, I'll call the plan sponsor and offer to review individual employee accounts." Moskowitz confines his advice to showing employees sample asset-allocation plans.

Other firms that provide 401(k) services online include BenefitStreet and 401kBrokers.com. Hal Schweiger, an adviser with Capital Financial Advisors, a fee-only firm in San Diego, has used BenefitStreet—a third-party administrator with about 1,000 plans holding $1 billion in assets—to set up a dozen small-business plans in the last 18 months. "They draw up plan documents, they do the enrollment and set up the accounts, and take care of the administration," Schweiger says. "I write up an investment policy statement and do the employee education." In addition to working with the business owner, Schweiger reviews the employees' asset-allocation strategies, which a reimplemented with Dimensional Fund advisors (DFA) funds—a BenefitStreet strategic partner—for a passive investment approach. (Although Schweiger prefers DFA funds, advisers using the BenefitStreet platform aren't restricted to them.) According to Schweiger, BenefitStreet, which uses Fidelity as its custodian, will provide TPA services for a plan for a $1,200 base annual fee and $25 per participant, with a minimum $ 2,000 annual fee.

Because of its use of low-cost Vanguard funds, 401kBrokers.com, founded by attorney Craig Gillooly of La Jolla, Calif., is popular among fee-only advisers. "The firm provides the plan, does the administration, and charges 25 basis points from participants' accounts—either their 401(k) account or a personal checking account," says Chip Addis of Addis & Hill in Wayne, Pa., who used 401kBrokers.com for his own firm's retirement plan. The provider can also accommodate solo 401(k)s.

To compete with these upstart online 401(k) providers, some large custodians are offering online platforms of their own. Schwab's bundled 401(k) plan, for example, provides record keeping, administration, plan design, investment and plan consulting, and compliance testing for business owners. But the service caters to larger clients: businesses must have a minimum $10 million in assets to set up a self-directed brokerage account and a minimum $25 million for access to Schwab's institutional trust funds.

Fidelity Investments offers a Web-based 401(k) platform through its Institutional Services Company. The platform provides online access to overall plan and participant account information. Participants have access to online enrollment, as well as the ability to exchange funds and make loans and withdrawals. The platform also provides services that include administration, investment policy statement development, participant education, and tools for advisers to develop plans with their small business clients.

Of course, some advisers will persist in doing their own thing. "I interviewed a few TPAs referred by Fidelity and picked two to work with," says Podnos. "But I use Fidelity strictly as a custodian." By limiting Fidelity's involvement, Podnos says he has more con trol to modify clients' existing 401(k) plans to provide them with lower-cost indexed portfolios from which he takes an asset- based fee of 0.5 percent for portfolio rebal ancing and participant education seminars. "I'm not sure it's all worth it time-wise, but I've enjoyed the learning process, and my clients are getting a much better and cheaper plan than they would with the typical group annuity plan," says Podnos.

DAVID J. DRUCKER (**dd@daviddrucker.com**), CFP, fee-only financial adviser, is coauthor of *Virtual-Office Tools for a High-Margin Practice* [Bloomberg Press] and editor of the *Virtual Office News* newsletter.