

Sound Investing - October 27, 2006

Interview with Yannis Koumantaros of Spectrum Pension Consultants, Inc.

Paul: Is it a myth or is it a reality that most people in the investment business understand how investing works? Actually, there are two major ends in this business. One end of the business is the people who are analyst and portfolio managers, whose job is to buy and sell stocks. They really aren't expected to take responsibility for asset allocation or any of the challenges that the individual investor would have to face. They have a very specific charter. Whether they're large cap, small cap, value or growth, they are managing a portfolio. Their job is to try to do as well as the benchmark or better. It is interesting that most of them don't beat the benchmark. At the other end of the profession, we have people who are investment advisors. They are planners. They are experts on understanding the individual investor, and understanding what the best steps are for that individual investor to be financially secure now and in the future. They make sure that they have the right assets, low expenses and low taxes. Also they develop a custom portfolio that addresses their personal risk tolerance. From my personal experience, most advisors don't do a very good job. They don't seem to understand how investing works, because most of them still seem to recommend products that are not in fact in the best interest of the investor. So, either they don't understand how investing works or they just don't care.

Not long ago, a big lawsuit was filed against 7 of the biggest companies in the country: Lockheed Martin, General Dynamics, United Technologies, Bechtel Group, Caterpillar, Exelon Corp, and International Paper Co., alleging that they have been charging excessive and illegal fees to employees in their 401(k) plans. This suit could have some wide ranging ramifications as it goes through the court system. To help us understand the underlying issues, we have with us a retirement plan expert from Spectrum Pension Consultants, Yannis Koumantaros. And, Yannis welcome to the program.

Yannis: Why, thank you. It's great to be here.

Paul: Yannis, this is a big deal, because it looks to me like the public and 401(k) participants are finally going to have their eyes opened to what has been going on inside of these plans. By the way, this is over \$60 billion worth of plans they're talking about here. How would you describe what is going on? How is this harmful to the participants?

Yannis: Well, there are big bucks at stake. You said \$60 billion amongst those 7 plans. Obviously, as we all know the trickle down effect is you start out big and work your way down. So, a lot of your listeners are probably wondering what is going to be the down-stream impact of this? Just to comment, the heart of the matter is there are fees that are inherently built into the products within the 401(k) marketplace. Those fees are typically referred to as revenue sharing or soft dollar commissions, etc. That essentially gets paid to different service providers. In a perfect world, those fees that are collected would be fully disclosed and fee transparent to the 401(k) plan, and could essentially cover only the extent to which the fees should be charged to 401(k) plans. The big issue, on these 7 large asset plans, is that those revenue sharing and soft dollar payments essentially were far in excess of the work actually rendered. So, basically these huge 401(k) plans have been over paying service providers.

Paul: To whom are these being paid? Who are we talking about?

Yannis: Well, for these 7 plans, the retirement plan marketplace arrangements that they utilize are essentially product based plans where they're through the large institutions/firms. I probably prefer not to comment on specifically which big institutions they are, but many are the financial services firms.

Paul: So are these the financial services and brokerage firms that you are talking about managing these plans?

Yannis: You got it. The brokerage firms that act as record keepers and custodians are essentially receiving these payments.

Paul: So, let me pretend for a second, I am a fiduciary. I am a trustee on one of these 401(k) plans. I am there to protect the participants in that plan. My job should be to look for any conflicts of interest, to make sure that the plan isn't paying higher fees than it has to, and to make sure we are in mutual funds that have low turnover or all of those things that might end up impacting all of those people that I represent. What's going on here? How can fiduciaries be working for somebody else other than the participants?

Tom: You can tell this riles Paul up.

Yannis: It riles Paul up. I'm glad to hear that Paul, because it riles us up here at Spectrum as well. The big firm that filed these litigations on these 7 companies and more to come is Spencer Fane Britt and Browne. They're alleging a plethora of things, but the most important items being mentioned are that these fees and expenses are unreasonable, and that the fiduciaries failed to monitor the fees and expenses. They were not informed. They had no idea to the extent which these fees and expenses were being over paid and there was no disclosure. All of which has harmed the participants, resulting in their account balances being a lot smaller today than they would've been if the fiduciaries were properly monitoring, were actually informed, knew exactly what was being paid, and knew what the expenses in the mutual funds offered in those plans actually were.

Paul: Yannis, are they saying that the fiduciaries/the trustees were stupid or complicit?

Yannis: I think that any taxpaying American would probably say that none of the fiduciaries intended to do harm to the plan. This is really a negligence lawsuit, where fiduciaries didn't act. They didn't properly monitor, and indirectly the participants are harmed. Paul, just to give you a real life example, you can have an identical mutual fund in 5 different retirement plans, and have 5 different share classes of the exact same mutual fund with the only difference being the expense ratio. When you move upstream to the \$5 billion and \$10 billion plans, the difference in one share class and the saved expenses that are inherent to moving up or down one share class is tremendous. That's really where these allegations, and the negligence, are really coming through.

Paul: The reason I ask about the complicity of the trustees is because most of these people didn't get to where they are because of being stupid. Is there any suspicion of any proprietary in the allocation of those payments possibly back to trustees?

Yannis: I think that most trustees are probably, to a certain extent, not benefiting from a financial perspective. I guess only time will tell on what specifically comes out on these 7 different lawsuits and the more to come down the road. I think that the key here is that the big financial institutions that received these excess payments are the ones that really benefited, and they're going to essentially be held I think to a certain extent; at least they'll be named in the lawsuit to essentially help restore monetary losses. But yeah, if you fail to do a trustee duty, you can literally face personal liability in certain cases, such as Enron; really be faced with potential jail time.

Paul: Well, and let's be realistic here. It is possible that when you're talking about a few companies representing over \$60 billion in 401(k) that those trustees are in fact being compensated for being a trustee. Isn't that true?

Yannis: Oh, absolutely, they're in large asset plans, and especially publicly traded or what people would call fortune 1000 companies. A lot of times board members, members of the board of directors, as well as trustees in the retirement plan can be compensated. The offset on that is sometimes corporate trustees are named. Really what you have is a corporate trustee, i.e. a large financial institution, a bank, or trust company acting as trustee and you have a pension committee that is responsible for ensuring that the duties are properly executed.

Paul: Isn't it possible that those trustees are being entertained by these financial institutions?

Yannis: Oh Paul that would be harsh of me to comment. But there may be some fringe benefits, that may be received by the trustees, that maybe aren't documented.

Paul: I smell good old boys here.

Yannis: You might smell the good old boys.

Tom: This is an important question for the listeners. I'm sitting at home thinking okay, I don't work for Lockheed or Bechtel. How does this impact me with my 401(k) and my 100 employee company?

Yannis: That's a great question. The reality is these law suits are moving downstream. It's a matter of time. Obviously, any good business man, whether they're an attorney or in any other professional service profession, are going to look for the lowest hanging fruit. And, if there's any impropriety, if there's a negligence claim, the largest dollars come in the large asset plans. But yeah, these law suits are coming downstream very rapidly. And, I think that if you are a trustee, on a pension committee or a fiduciary of a fairly good large sized plan, you have to be at least somewhat concerned about the ability for the class of employees to file a class action lawsuit. There's a lot of firms that are reaching out and going after these middle market 401(k)s. And we're seeing the lawsuits coming down from even the less than \$100,000,000 in plan assets to closer to \$20 – \$25 million in assets.

Paul: People are going to have to start paying attention to this. We will follow up with this in the future. Yannis, thank you very much. Yannis Koumantaros from Spectrum Pension Consultants. We'll have a link to their site at fundadvice.com.