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ICG TIMELY TOPICS

From The Top

Back in the 1990's, especially 1996 – 1999, with a hot stock market, it appears ethics went out for a three-martini lunch! (Remember those days?) Now everything is focused on ethics. The market continues to be strong but companies are still struggling with corporate ethics. A true acid test of the ethics of any issue is if you would be concerned that your friends, family and newspaper knew about the issue. When all else fails it is your personal ethics that matter most.

Lastly something to think about. Why do people who laugh at fortunetellers, believe in economists?

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Article Summaries

**Miller, Rick “IMCA launching a website for wealthy investors” Investment News Vol. 8, No. 26
September 27, 2004 p. 27**

The Denver based Investment Management Consultants Association launched a website, investmenthelp.org, that is designed to provide objective financial information. It is not meant to teach you how to be your own financial adviser but to help you expand your knowledge about how your assets should be prudently managed. IMCA expects the website to also raise public awareness of investment consultants and the 5,000 member association, which turns 20 years old next spring. Examining other investor education websites, IMCA found that they generally were too simplistic for the affluent clients of IMCA members. For the site's content, IMCA is rewriting for a non-professional audience some of the research and scholarly articles that it runs in the IMCA Journal of Investment Consulting. The website will also feature book reviews, commentary on common investment mistakes, a glossary of financial terms, streaming videos, frequently asked questions, financial and legislative news, financial calculators and stock market information.

Editors “Pensions outperformed 401(k)s during bear market” The Adviser Newsletter (Employee Benefit News) On-line December 1, 2004 pp. 2, 3

Most investments performed poorly during the bear market of 2000 to 2002. Retirement and financial advisers, however, might be surprised to know that 401(k) plans were outperformed during that time by, of all things, defined benefit pension plans. During the three-year market slump, rates of return for 401(k)s dropped progressively, from minus 4.28% in 2000 to minus 12.26% in 2002. Meanwhile, Defined Benefit plans remained flat in 2000 and then dropped as low as 8.43% in 2002. The average difference in median rates of return between the two types of plans was 3.8%.

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The DB plans' superior performance is not a surprise because pension managers have a fiduciary duty to diversify investments. Meanwhile, 401(k) participants have tended to invest too much of their portfolios in stocks. 401(k) participants would be wise to maintain a well-diversified portfolio in order to weather market fluctuations more smoothly.

Anderson, Tom “*Plan sponsors demand more employee financial education*” Employee Benefit News November 2004 Vol. 18, No. 14 pp. 1, 61

Many plan sponsors are focused on increasing the number and quality of financial education programs offered by their plan providers, vendors and consultants. High profile mutual fund scandals and government probes into the investment industry have raised issues in the mind of plan sponsors. This is reflected in the increase in the number (estimated at 30% to 40% from previous years) of plan sponsors requesting information from vendors.

More plan sponsors are asking providers to show their commitment to financial education by requesting specific amounts dedicated to it. Not all plan providers say that their clients are interested in putting more money into financial education. However if a financial education program isn't working, plan sponsors need to start asking questions about why it isn't working, not putting more money behind it. An effort to spend money wisely is why some plan sponsors are asking their providers to give them a breakdown of fees that go to financial education.

There's a lot of scrutiny over fees. I think many plan sponsors are doing a market check to figure out what level of fees is appropriate. A study found that the average plan cost was 0.62% of assets under management. Total plan cost is a good overall benchmark for 401(k) plans, but employers should make sure when they request information from plan providers that the financial education fees are listed in a consistent manner so the employers will be able to easily compare programs. Financial programs should align with a company's strategic goals.

Jacobi, Arleen “*Kmart-Sears deal no Blue Light Special for some in real estate*” Pensions & Investments November 29, 2004 pp. 2, 46, 47

Kmart Holding Co.'s purchase of Sears, Roebuck and Co. might be bad news for institutional investors in some real estate funds and real estate investment trusts. The reason: Edward S. Lampert, the power behind the deal, is expected to cut costs by closing Sears stores located in malls. And malls are the major component of institutional investors' exposure to retail real estate. From a big-picture standpoint, the big winners are neighborhood shopping center owners and it is a huge negative for mall owners. Real estate insiders say that it will be months before they know whether the combined Sears and Kmart with 3,500 stores, will be a real estate bonanza or bust.

No one is certain how many Sears stores will be closed, but some analysts are predicting as many as 1,000 within two years, as the retailer transitions from multilevel malls to standalone “big box” stores. Potential strategies for excess real estate of the combined companies include spinning off the properties into a REIT, entering into sale/leaseback contracts for core holdings or selling real estate interests to vulture real estate managers and operators. Each could lead to investing opportunities for real estate managers, REITs and institutional investors. However not all investment managers expect a real estate bonanza from the merger. More information is needed to make that determination.

Editors “*Women Increasingly Gaining Financial Clout*” Benefits & Compensation Digest Vol. 41, No. 10 October 2004 p. 15

At least 88% of baby boomer women have sole or joint responsibility for products such as investment accounts, annuities and life insurance. The study also found that women want education on financial matters and financial professionals are their preferred source. However, only one in ten respondents said that they will definitely follow through with specific actions that could lead to their own long-term financial security, including opening an IRA and meeting with a financial professional to develop a formal financial plan. In another finding 78% feel securing a comfortable retirement is very important, but only 12% are confident they will not outlive their savings. The 1,134 respondents were born between 1936 and 1979.

**Swisher, Pete “*What plan sponsors must know about 401(k) revenue-sharing deals*” BenefitNews.com
September 28, 2004 pp. 1-9**

The SEC’s investigation into the 401(k) revenue-sharing practices of several major fund families has put the focus on these under-the-table payments as never before. Are these payments legal or illegal? If legal, are they ethical?

Mutual funds pay money to vendors who sell the fund families’ product, but plan sponsors rarely know these payments exist. These revenue-sharing practices, or kickbacks (perhaps an unfair term), are currently legal if the vendor collecting the payments is not a plan fiduciary and typically take the form of rebates of fund expense ratios in amounts ranging from .25% to .50%. Full range is 0 to 1.00%. Kickbacks may still be legal even if the vendor is a fiduciary but does not have full discretion. The SEC is especially interested in the level of disclosure and conflicts of interest, thus the current investigation.

There are five types of revenue-sharing. 1) Finder’s fee: Typically a 1.00% one-time payment by a fund family to the broker of record that does not incur any sales charge to the client. 2) 12b-1 fees: Another form of commission to the broker of record, typically a .25% “trail” payment commencing as soon as assets are transferred. 3) Shareholder servicing fees: A sneaky name for 12b-1s paid by “no load” families, since 12b-1s are considered a commission, or load. Fund families known as “no load” families can pay up to .25% and not be required to call it a 12b-1, but only service providers, not brokers, can receive these payments. 4) Sub-transfer agency (sub t/a) fees: Originally a payment to a recordkeeper with an “omnibus” account at the fund family that allows the fund family to eliminate hundreds or thousands of individual client accounts in exchange for one big amount. Eliminating all those small accounts saves money, and the fund family passes part of the savings on to the recordkeeper. In recent years, however, the use of sub-t/a fees has expanded to become an alternate means of providing revenue-sharing to various service providers, not just recordkeepers. Brokers are not eligible to receive these payments. 5) Standard sales commission: Paid by load funds. Loads are generally considered as being separate from revenue-sharing. “No load” funds do not pay commissions, but usually still pay shareholder servicing fees, sub-t/a fees or both. Only a handful of no-load fund families pay no revenue-sharing whatsoever. Furthermore, most fund families have multiple share classes for each fund with each share class providing a different payment to vendors.

Like all tools, revenue-sharing can be used for good or evil. Large-scale vendor searches can be extremely competitive, and plans with assets over \$10 million (and often less) can expect to receive at least one bid showing that the plan is “free.” This just means that there are no fees that anyone sees, with the fund expenses carrying the cost burden of the plan. In a more insidious example of the “yeah, but it’s free” school of 401(k) vendor searches, some truly good services offer excellent programs that, nonetheless, disguise an underlying conflict of interest that is invisible to the client. In these cases, a plan with sufficient assets can get “A” shares of load fund families at Net Asset Value (NAV), or “no load.” The problem is that the vendors putting the solution together want the plan to be “free” or close to it, but they still want to get paid. Therefore, they limit themselves to those funds from which they can obtain sufficient revenue-sharing to offset all costs of service.

In a perfect world, revenue-sharing would simply be a number subtracted from expense ratios to determine the true cost of money management. A fund costing 1.00% but refunding .50% is still more expensive than a fund costing .40% and refunding none. Cost is certainly not the only consideration in selecting investments, and is not even the most important consideration, but true net cost is the number to target when evaluating fund and plan expenses.

Revenue-sharing is a good thing. Free money in general is a good thing. The problem is not that fund families make payments, the problem is whether the payments are put to the best possible use to benefit plan participants. There is a simple way to ensure that the interests of the plan and its participants coincide perfectly with the interests of the vendor – full revenue-sharing and disclosure. When a vendor passes through 100% of revenue-sharing payments, it has no incentive to do other than choose funds based solely on the best interests of participants and beneficiaries.