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Key Questions for 401(k) Participants

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09/05/2003 07:13 AM EDT

URL: <http://www.thestreet.com/funds/stephenschurr/10111166.html>

Donald Trone, director of the Center for Fiduciary Studies, a nonprofit group that offers training for retirement-plan sponsors and providers, has provided fiduciaries with a list of questions that they should ask themselves regarding their service to 401(k)-plan sponsors and participants. Participants in 401(k) plans would be well served to acquaint themselves with these questions when considering the service they receive.

Best execution: Has the client's money manager(s) sought "best execution" on all securities transactions initiated for the benefit of the client?

Soft-dollar usage: Are the soft dollars generated by the trading activity of the client's account being used for the exclusive benefit of the client?

Directed brokerage: If the client "directs" that a particular broker dealer be utilized for trading, has the client been informed that the direction may have a negative impact on the client's investment performance and/or result in higher expenses?

Wrap fee programs: If the client is using a wrap fee program, are the money managers available in the wrap fee program "encouraged" to place a certain percentage of their trades through a particular broker dealer? If so, has the client been informed that the wrap fee arrangement may have a negative impact on the client's investment performance? Has a cost comparison been made to determine whether the client could acquire the same wrap fee services on an unbundled basis for less money?

Commission recapture: Has the commission recapture account been closely monitored to ensure that the account is used for the exclusive benefit of the client? [Considered a second cousin to directed brokerage since commission recapture programs also involve an element of directed brokerage.]

"Pay-to-play" schemes: Is the client using an investment consultant who, in turn, is squeezing money managers to buy highly inflated services or conference seminars from the consulting firm? [The obvious implication is that if the money manager wants to be considered in searches conducted by the consultant the manager must "pay-to-play."] If so, how are the managers paying for these "services?" [More often than not with "orphaned soft dollars" -- soft dollars generated by clients who are not monitoring the use of their soft dollars.]

12b-1 fees: Is the client aware of the total revenues being generated by the 12b-1 fees? Is the client aware of all of the parties sharing in the revenues and the amounts being received by each? If the client is receiving bundled services in exchange for the 12b-1 fees, has the client determined whether the same services can be acquired for less money on an unbundled basis? [Easily likened to soft dollars in use and abuse and is a high priority with the DOL auditors.]

Unitized accounts: If a 401(k) investment committee has more than \$25 million dollars in one particular investment option, has a cost comparison been made to determine whether a unitized separately managed account would be more advantageous than a mutual fund?

Load vs. no-load: Is the client receiving comprehensive and continuous investment advice from an investment adviser? If so, has the adviser implemented any of the client's investment decisions with a load product? If so, can the adviser demonstrate that the load product, as opposed to a comparable no-load product, was in the best interests of the client?

Mutual funds vs. separate accounts: Has the client been informed of the pros and cons of both mutual funds and separate accounts, particularly the fees and expenses associated with both?

Passive vs. active management: Has the client been informed of the pros and cons of both passive and active management, particularly the fees and expenses associated with both?

Share class: If the client's investment strategy is being implemented with mutual funds, has the most advantageous share class for the client

been selected?

Source: Center for Fiduciary Services report, "You Deserve To Be Fairly Compensated -- But Not More So," April 2002.
