



## **Participant Specific Advice – Where Defined Contribution Becomes a True Employee Benefit**

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### **West Chester Capital**

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## Introduction

*The defined contribution plan has become the dominant vehicle for funding and investing for retirement in the U.S. It is becoming increasingly clear that costs are high, returns are poor and employee/participants are not being well served.*

The sea change is well underway and irreversible. Your father's pension was in all likelihood a defined benefit. The company funded, invested and defined a pension benefit for employees based on years of service, income, and other factors. The company was responsible for funding the pension, investing it and making sure it had the assets to pay all of the pensioners. Their cost, their responsibility, their investment risk, their administrative burden.

Your pension will in all likelihood come from a defined contribution plan such as a 401-k. You will be the primary or sole contributor to your pension. You will be responsible for deciding how much of your income to defer into the plan. You will be responsible for choosing the appropriate mix of investments to adequately fund your retirement. You will be responsible for re-balancing your mix periodically. Your cost, your responsibility, your investment risk, your administrative burden.

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Nifty trick isn't it? That sea change is but one of the ways corporations have offloaded costs, risks and responsibilities onto their employees over the past twenty five or so years. Even the language makes it clear: a defined benefit has given way to a defined contribution. It may not even be much of a benefit for most participants anymore. The result for most folks who would eventually like to retire after a working lifetime is that they are on

their own. Your company may provide access to a 401-k, but the rest is up to you. Moreover, there is plenty of evidence that nationwide, 401-k costs are high, disclosure is low, participation is low, participants hold too much cash, and resultantly, returns are sub-par. This is almost certainly a direct result of the fact that the company is no longer bearing much if any of the cost of the plan. The cost is typically paid for primarily by the participants, yet they have little ability to dictate what vendors serve them. This disconnect has been exploited very well by many of the leading 401-k vendors of today.

The question is this: How valuable is an employee benefit that forces the employee to provide all or most of the funding, make all of the investment decisions, manage the program over a working lifetime, pay too much in expenses, bear all the investment risk, and collect sub-standard investment returns due to all of these factors? The answer is: Not as valuable as it could be.

Plan sponsors are beginning to recognize this problem. They are also beginning to realize that as fiduciaries, they may have more responsibility than they know. If participants don't fully benefit from the plan, it isn't really a benefit. As a result, plan sponsors are reviewing their defined contribution plans and vendors with an eye towards several important changes.

First and foremost is cost. 401-k providers have ridden the gravy train of the sea change, capturing assets as 401-k plans proliferated, while little attention was paid to plan expenses. As lowering expenses is the surest way to boost returns, this is an obvious place to gain efficiencies. Also, since many plan costs are buried and poorly disclosed, it is often difficult for participants to fully understand what their true costs are, and how much it may be diminishing their returns. Costs come from multiple sources in a 401-k. From mutual fund or investment management fees, 12b-1 or other marketing fees, and from recordkeeping. Fees have been so lucrative that there are many hidden fee sharing arrangements between these various vendors and marketers. Full transparency is the obvious remedy. Plan sponsors have only to demand it.

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Founded in 1994, West Chester Capital is a registered investment advisor managing \$150 million of client assets. Located in West Chester, Pennsylvania, West Chester Capital is a wholly owned subsidiary of AmeriServ Financial, a publicly held bank and trust company, headquartered in Johnstown, Pennsylvania. AmeriServ is a \$1 billion bank with a trust company administering \$1.8 billion in client assets.

West Chester Capital manages fiduciary quality portfolios and investment programs for individuals and institutions within a framework of openness, integrity, objectivity and rigorous client advocacy.

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Second is participant education. Well informed participants will make better investment choices, invest more fully and remain fully invested. The value of the employee benefit increases dramatically. The cutting edge in this regard is the ability to offer investment advice to individual participants. A 401-k plan with forty mutual fund choices is of relatively little use if the participant does not know how to select appropriate funds and blends of funds, to achieve their specific retirement goals. The rub is this: not all 401-k vendors are able to offer participant specific investment advice. Yet this is where most participants, and plan sponsors will get the biggest bang for the buck. It is where a nominal employee benefit truly becomes a valued and valuable employee benefit.

Improving participant returns, even a little bit, over time, adds meaningfully to the end results. Small improvements compound into large, sometimes very large results, over time. There are really only a few variables that drive investment results: returns, time, starting asset value and funding or contributions. Lowering costs is the most direct and certain way to boost returns. Choosing the right asset classes and mix of asset classes is the next best route to better participant returns. This is where participant specific advice will earn its keep.

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June, 2008*

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