

## Mutual Funds

### A gold-plated 401(k)

In Oklahoma, a cardiology practice tossed out a terrible retirement plan and built one we'd all like to have.

By [Timothy Middleton](#)

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If you're stuck in a lousy 401(k), show this article to your boss. It proves that excellent plans exist among small and mid-size employers, as well as the Fortune 500.

After dredging up an array of bad retirement-plan practices, such as 401(k) plans [loaded with high-cost annuities](#), I found a plan that's the model of excellence.

It has all the features I look for in a high-quality 401(k) plan, starting with a vigilant employer that's actually performing its fiduciary duty. The company makes a hefty contribution, even if workers don't, and makes it in cash rather than company stock or some illiquid form.

Vesting is quick, participants can borrow against their balances and administration is state-of-the-art. Professional investment advice is free, and comes from more than one source. But the basic plan design, which features automatic quarterly portfolio rebalancing, is so popular that virtually all participants use it.

That design rests on portfolios of low-cost index funds, the optimal choice for long-term investors, [as I explained in a column](#) in August. They eliminate the risk that managers will fail to keep pace with the market -- and most do fail -- and that management companies will fritter away shareholder profits on commissions to salesmen and kickbacks to middlemen, which is so widespread the Securities and Exchange Commission is mounting a major investigation.

### In the land of the Sooners

The plan is found at Oklahoma City-based Oklahoma Cardiovascular Associates, the state's biggest cardiology practice. Oklahoma Cardiovascular Associates' plan is as up-to-date as the 78-bed Oklahoma Heart Hospital, a two-year-old paperless facility half-owned by the company's 39 physicians that uses tablet computers instead of paper charts and forms, and an intranet rather than bulky files. It performs 1,200 open-heart surgeries annually, and operates an air ambulance to bring in patients and ferry doctors to clinics

around the state.

The plan is even more impressive when you consider that Oklahoma Cardiovascular Associates once had a rotten retirement plan.

“Expenses were in excess of 2%,” says Pat Holloway, chief executive of the 400-employee physicians’ group. “Presumably those fees were for full-scale solid professional management, but it didn’t seem as though we were getting what we were paying for.”

So Oklahoma Cardiovascular dumped the annuity-based plan.

In the new plan, the company contributes 6% of base pay for employees, even if they don’t contribute anything themselves. They can, however, contribute up to the maximum the IRS allows. The company pays all the plan’s costs above the expense ratios of the mutual funds, which average 44 basis points, or hundredths of a percentage point. By contrast, the average equity mutual fund charges more than 1.5%.

The funds are index portfolios designed and managed by Dimensional Fund Advisors. I wrote a [column](#) about these funds in June 2002, calling them the “best funds you can’t buy.” They can be purchased only through financial advisers who are experts in indexing and have been trained by DFA.

### **Searching for optimal performance**

DFA uses the Fama/French Three-Factor Model, which you can peruse [here](#) to build indexes that tweak markets for supposedly optimal performance. The advisory firm hired by the plan to oversee investments, Investor Solutions of Coconut Grove, Fla., in turn tilts portfolios in favor of small and value stocks, which professors Eugene Fama and Kenneth French demonstrated outperform large-growth companies over long periods.

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Frank Armstrong, Investor Solutions president, has created a series of what he calls life-cycle strategies, which are 100% equities for youthful employees, ranging to 40% equities and 60% fixed income as they approach retirement.

One of the former type, termed “Aggressive Model,” breaks out like this: large value, 15%; large growth,

10%; small value, 15%; small growth, 10%; international large value, 12.5%; international large growth, 10%; international small value, 12.5%; international small growth, 10%; and emerging markets, 5%.

The plan's portfolios are fully transparent mutual funds like **Dimensional International Value (DFIVX)**, which zoomed ahead 26.6% in the 12 months ended Oct. 27, better than 94% of its rivals in the Morningstar database.

Armstrong's company automatically rebalances participants' accounts quarterly. He also provides a newsletter for employees explaining markets and the DFA approach.

"The people we were using before were nice guys and honorable people, but we were not getting near the expertise or the insight we're getting now, for less than half the price," says Dr. John Robert Harvey, the company's chief physician.

### **Finding other opinions**

The cardiologists also distribute independent newsletters from a company called Write Communications of Ponca City, Okla. Participants in the plan don't have to use Investor Solutions. Among their alternatives is a direct-brokerage account, through which they can buy any stock, bond or mutual fund available to IRAs and other tax-deferred plans. But "none of our employees are utilizing" the direct-brokerage option, says Mary Mills, the firm's human resources manager.

Very few 401(k) plans offer much in the way of investment advice, and those that do are dominated by so-called bundled providers -- companies that supply everything from investment portfolios to administration. The industry likes this approach because it's the easiest way to sneak in high expenses, like 5% commissions to the brokers and insurance agents who sell the plans. They can also use newsletters to implicitly tout their products.

The plan adopted by the Oklahoma cardiologists is unbundled. The company selected Investor Solutions to offer advice, DFA to run the investments and an expert plan administrator, Heintzberger Co. of Portland, Ore., to serve as record keeper, handling back-office work such as sending out statements, keeping the books and operating the plan's Web site. Each was chosen separately and none shares revenue with the others. Elsewhere in the 401(k) business, kickbacks and revenue sharing are common.

And they're common because most employers are ignorant of their fiduciary duty to participants, which includes a duty not to waste their assets on unnecessary expenses. They haven't bothered to educate themselves because enforcement of these rules, which is broadly spread over a plethora of agencies, from the Labor Department to state insurance commissioners, "is close to zero," Armstrong says.

Holloway, the chief executive, estimates the total annual cost of the plan, both the portion paid by participants in the form of expense ratios and the portion paid by the company for overhead, at about 125 basis points, or 1.25%. So even if the company didn't subsidize the administration costs, it would still be economical for participants, 25 points less than that average mutual fund.

### **High costs**

In bad plans, annual costs often exceed 200 basis points, or 2%, and are wholly paid for by participants. Annuity plans can cost even more, and often also impose surrender fees, or back-end loads, than can run for seven years.

Participants in the doctors' plan can borrow against their plan balances, using systems designed by Heintzberger. Most experts recommend against doing so, and many paternalistic (or just cheap) employers don't make loans available, but they can be a valuable benefit if used appropriately.

The Oklahoma plan has assets of roughly \$10 million, which puts it on par with a wealthy family, such as

one that owns a small business, rather than the Fortune 500. Its fundamental strength is that the company is pinching its own pennies. Bosses don't waste their money. Bad plans come from bosses who don't care if employees waste theirs.

In recent weeks I've gotten hundreds of e-mails from readers about their 401(k) plans, and several have come from controllers of small companies looking for guidance in selecting a plan administrator. These e-mails are evidence of what Armstrong says he has seen in his own practice, that some employers know far less about investing prudently than their workers do.

If your boss belongs to that group, and the proof is an expensive, unpalatable plan, tell him to wake up. Finding cheap, good plans isn't hard. I found Armstrong with an e-mail to the [National Association of Personal Financial Advisors](#), an estimable group of pros who work for fees, not commissions and kickbacks.

*At the time of publication, Timothy Middleton didn't own any securities mentioned in this article.*

*If you would like additional information on the (DFA) Dimensional Fund Advisors please email us at [schulmerich@comcast.net](mailto:schulmerich@comcast.net) or call us at 503-672-7750 Toll Free 888.866.5639. Web Site [www.schulmerichandassoc.com](http://www.schulmerichandassoc.com)*