INSTITUTIONAL INVESTOR
OCTOBER 1994

# The SQUEEZE on fees

Money managers who think their industry isn't mature and that cost pressures can't touch them are kidding themselves.

By Alyssa A. Lappen

FPG

Money managers, so quick to pronounce businesses mature, labor under a common misconception when it comes to their own business: "Maturity can't happen here."

Good morning, folks.

"For at least ten years, maybe 20, I've been hearing about the coming pressure on management fees," says Richard Cantor, executive partner of Neuberger & Berman and a senior statesman of the money management industry. The talk doesn't faze Cantor. In 55 years of doing business, Neuberger has suffered pressure on fees only at moments of market decline, he notes. The rest of the time, the partnership has grown nicely, to $30 billion in assets. "Perhaps I'm just suspicious or jaundiced," Cantor continues, "so I tend to think less of macro events than of things I can do internally to keep our business profitable and growing."

Yet these days, to keep their businesses growing profitably, money managers essentially either have to steal clients from someone else or cannibalize their own accounts. A few voices have begun to warn insistently that the industry is no different from any other maturing business. "There are economies of scale and, just as in any maturing industry, economies lead to price pressure," says Ron O'Hanley, a consultant at McKinsey & Co. C. Richard Pogue, executive vice president of the Investment Company Institute, agrees: "I don't see anything that distinguishes money management that would protect it from price competition."

Signs of trouble are surfacing for anyone who is willing to pay attention. Prices in some market segments long ago began to erode or crumble altogether. True, the barriers to entry remain relatively low — there are easily more than 10,000 money managers in the U.S., and more hang out shingles every day. But the cost of marketing and servicing clients has grown phenomenally. "There is fee erosion and there is a decline in overall profitability, but money managers don't see it because their assets and revenues in many cases are still growing 20 percent a year and the large players have achieved economies of scale," asserts Paula Brancato, a veteran of Bankers Trust Co., Morgan Stanley & Co. and McKinsey who now consults to the industry at Brancato Fritsch & Co. in New York. "Cash flow is so huge that they don't necessarily see the problem. It's a classic sign of a maturing business." One area that promises to be particularly hard hit is the blossoming 401(k) market.

Still, a surprising number of institutional and retail money

managers are in deep denial — perhaps lulled into complacency by the long-running bull markets. Average annual investment returns of 15 percent a year or more have kept assets growing, fees high and customers coming back for more. Money managers often compare themselves to surgeons, whose prices are rarely questioned. Listen to Brian Berris, a partner at Brown Brothers Harriman & Co., which manages $21 billion, mostly in domestic stock and bond accounts: "This business has been driven by the cost-of-value equation, and if money managers continue to deliver positive value, then the fees don't have to decline."

Brian Wruble, president of Delaware Capital Management, argues that "once you reduce prices, they are not likely to rise again, so there is very little impetus [for managers] to drop fees." Dreyfus Corp. chairman Howard Stein plainly endorses high fees: Most taxable retail Dreyfus money market funds charge expense ratios of more than 70 basis points, and investing in Dreyfus Growth and Income costs an annualized 114 basis points, despite the near tripling of the fund's assets in the past year, to close to $1.8 billion. But the 99-basis-point expense ratio at Fidelity Investments' $36.6 billion Magellan fund takes the prize: It has dropped only 8.3 percent since 1989, although assets have nearly tripled.

The institutional price squeeze is real, nonetheless. Consider its diverse sources:

• **A stagnant defined-benefit pool.** As of 1993 the estimated $2.7 trillion private and public pension market had grown less than 9 percent over 1992's tally, according to Sanford C. Bernstein & Co. Most of that growth came from market appreciation, not from new clients or plans — and what markets give, markets can take away. Meanwhile, defined-contribution plans grew nearly 40 percent faster, Sanford C. Bernstein reports. Thus pension officials project that within ten years, defined-contribution programs will account for 60 percent of all corporate pension assets.

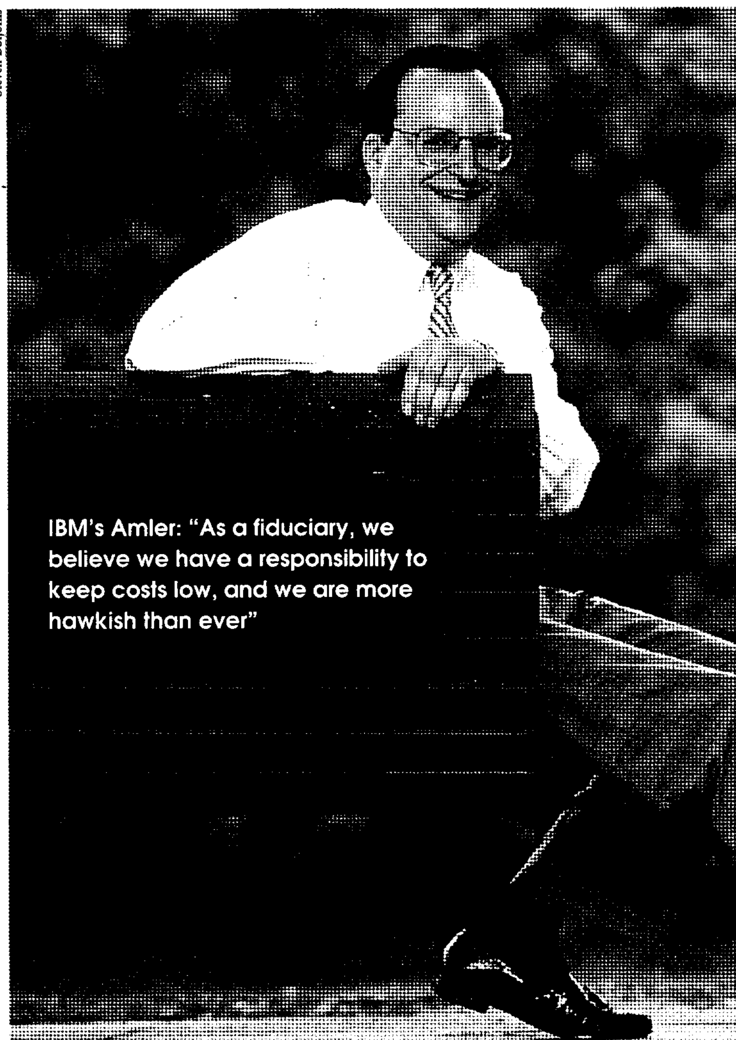
• **Stiffer competition.** The only way to obtain new defined-benefit business (and profits) today is to take away someone else's customers — or to shift assets from traditional products into newer, higher-priced arenas, such as international and emerging-markets equities and debt. Either way, it's an expensive proposition. Do nothing, and profits suffer. "This has been a take-away business for a long time," says Thomas Lucey, head of institutional management at Putnam Investments. "I am willing to reinvest in the business to make sure that I get new revenues and clients. And if that means downward pressure on margins, so be it." Dan Fitzgerrell, director of pension services at Principal Financial Group in Des Moines, Iowa, concurs: "Yup, there is competition, and margins will shrink."

• **The spread of indexing.** Use of low-cost equity indexing grew 19 percent a year from 1985 through 1993 among corporate plan sponsors and an even higher 25 percent among government sponsors, according to data that Eager & Associates compiled from *The Money Market Directory of Pension Funds and Their Investment Managers.* In the same period, corporate sponsors increased their actively managed equity accounts by a modest 7 percent a year. In all, about one quarter of the pension universe today is invested in indexed accounts, Greenwich Associates reports, up from 22 percent in 1992 and 20.6 percent for corporate plans in 1988. These gains have occurred more slowly and unevenly than some observers expected, yet they ought to send a chill up the spine of active managers who don't consistently beat their benchmark index — which at any given moment is roughly half the management universe.

Growth in indexing has been fueled largely by price, and like any commodity in abundant supply, indexing can only get cheaper. The average fee for institutional-equity and fixed-income indexing is already only 10 basis points, according to Callan Associates, and banks like Wells Fargo & Co. and State Street Bank & Trust Co. index for as little as 3 to 5 basis points on some accounts. In short, indexing is one of the purest forms of price pressure, putting enormous and growing stress on the average 39-basis-point fees charged for active equity management. Moreover, if Vanguard Group chairman John Bogle has his stubborn way, indexing could spread even more broadly in the retail sector: Since their inception in 1976, Vanguard's index funds have claimed one third of the company's $50 billion in equity assets.

• **The advent of negotiating.** Few money managers admit it, but discounts off the fee schedule are now routine, particularly for accounts of $100 million or more. "Very few stick to the published fee schedules," concedes Putnam's Lucey, a fact corroborated by Callan Associates' 1994 fee study. Greenwich Associates, too, reports in its 1994 investment management study that the proportion of pension funds negotiating fees has been rising steadily — from 19 percent in 1989 to 25 percent last year — and that the percentage of funds that plan to seek fee reductions is also rising.

Just how low fees go depends on account size. But a survey of 111 U.S. pension funds with $616 billion in assets by Cost Effectiveness Measurement in Toronto found that large plans paid only 37.9 basis points last year for management — in-



Steven Boljonis

IBM's Amler: "As a fiduciary, we believe we have a responsibility to keep costs low, and we are more hawkish than ever"

cluding asset administration and custody. Greenwich reports that money management fees paid by pension funds averaged only 39.5 basis points in 1993, up just 2.2 basis points since 1989, despite a tectonic shift in assets to higher-priced international and small-cap equity accounts.

Factor in the impact of inflation, and those fees have declined considerably during the past five years, says Brancato Fritsch's Brancato. Fee pressure is exacerbated by some plan sponsors' insistence on getting "most-favored-nation contracts," under which managers must lower the fees charged to the signatory clients if, midcontract, another client gets a lower rate.

Another relatively new pension plan tactic is to consolidate accounts with one strategic partner, as GTE Corp. did in 1992 with Morgan Stanley Asset Management. GTE Investment Management Corp. president John Carroll says he has a significant portion of his company's $12 billion in retirement assets consolidated at Morgan and the savings are considerable, thanks not least to the added securities trading volume that GTE has given to Morgan as part of the pact.

• **Expanded services.** On the other side of the price-pressure equation are the very real costs that have lately been added to the business. "These days institutional managers have to provide consulting services such as asset allocation for no fee or a small fee," says Brancato. "And you have to spend money to create new products. Five years ago there were five traditional classes of products on the market. Now there are thousands of new products. Those took development and marketing, and that costs a lot of money."

Shawn Henry/SABA

Putnam's Lucey: "I am willing to reinvest in the business to make sure that I get new revenues and clients. And if that means downward pressure on margins, so be it"

Says Wesley McCain of Townley Capital Management in New York, whose fees are already extremely competitive: "Do I believe the absolute fee is going down for [the traditional pension] money managers? Yes, it is. The defined-benefit market is under enormous pressure. But it's not from other money managers. It's that the whole pie is beginning to shrink." Fees that used to cover money management alone must now encompass consulting, asset allocation and overall administration services as well.

• **Mounting market pressure.** None of this takes into account the fact that the equity and bond markets have been under stress, to put it mildly, since January. A continued run of bad performance will only compound the already extensive pressure on fees, costs and margins.

• **The institutionalizing of mutual funds.** At one time, smaller and midsize pension plans could go into expensive separate or commingled accounts. But an increasing number of money managers now offer institutional mutual funds — at a reasonable total cost. One such is Jeremy Grantham, whose Grantham, Mayo, Van Otterloo & Co. manages $15 billion in assets, half of it through 15 low-cost Securities and Exchange Commission–registered funds, and about 60 percent of it invested overseas. Grantham offers the GMO International Core fund, for example, at a total expense ratio of 70 basis points a year — and beats the international bogey by more than 6 percent a year.

With performance like that Grantham could presumably charge more, since the average account in his funds is only about $10 million. But he has more sense than that. Funds, he says, allow him to write one ticket instead of 40, pool all brokerage and custody charges and streamline fees. "There's been a steady increase in the amount of pension money going in-house and to indexing," he explains, "and that, coupled with the maturity of the pension market and bull-market high, means there will be a lot of scrambling at the margins, which is an environment conducive to fee pressure." Grantham's institutional clients are not particularly fee-sensitive, but they do, he adds, expect reasonable prices for reasonable performance. And some get quite agitated about the level of profits that most money managers rake off.

As pressures mount in their traditional business, more institutional managers are turning to the retail and 401(k) markets. In

retail the details are different, but the bottom line is the same. In money management, middle age has arrived.

In the brave new world of 5,500-plus mutual funds run by more than 500 fund families, heft is everything. The average mutual fund family needs $10 billion in assets just to survive and $20 billion to reach full economies of scale, according to a recent study by Goldman, Sachs & Co. Yet despite the 25 percent average rate of net annual sales in the industry in the past four years, ICI reports that only 25 families have more than $20 billion in assets. For the rest, growing will not be as easy as it once was. More competition means selling costs are higher and profits lower.

Pricing pressure has already been extensive among retail mutual funds with loads. As recently as the early 1980s, most retail funds were equity funds — and carried a steep 8.5 percent load. But by last year, when roughly two thirds of all mutual fund assets were invested in fixed-income or money market funds, the average sales charge on load funds had fallen to 4 or 5 percent, according to Lipper Analytical Services. A number of load funds had dropped sales charges altogether.

The well-known adage that funds are sold and not bought now seems considerably less tried-and-true. In the past four years, no-load funds have garnered nearly 45 percent of all mutual fund sales, according to ICI statistics, up from 37 percent in the late '80s. That increase may partly have come because of the advent of defined-contribution plans, which usually bypass loads even in funds that carry them. But educated consumers are no more likely to flood back into high-cost, front-end-load funds than shoppers in outlet malls are to flock back to pricey department stores.

As loads have been squeezed, the cost of distribution has risen in other ways, forcing many fund families to begin eating expenses. Instead of charging front-end loads to pay brokers on most of its funds, Legg Mason adds annual 12b-1 distribution fees of 50 to 100 basis points to the expenses of its 11 stock and bond funds. "We want to keep the client in the scope and encourage the broker to build the book of mutual fund assets year after year," says Edward Taber, an executive vice president at Legg Mason, which now has some $4.2 billion in mutual fund assets. But there are limits to what shareholders will pay. "We have capped fees at 195 basis points for equity funds and 90 basis points for most bond funds," says Taber. The result: To survive and grow, Legg Mason has also capped profits on six of its 11 long-term funds.

Competition in the brokerage community comes from two sides: the big, brand-name houses like Merrill Lynch (the third-largest fund family after Fidelity and Vanguard) and independent dealer–distributed groups like Colonial Group, Delaware, Putnam and Franklin/Templeton Group. To compete, all have beefed up their sales efforts at great expense.

Even no-loads have been forced to pay up for distribution as a crop of discount brokerage houses, such as Charles Schwab & Co. and Jack White & Co., have begun to cater to retail buyers much as the master trusts serve institutional investors. As of August Schwab had $12.5 billion in assets in its no-transaction-fee OneSource program, roughly triple the level just one year ago. White's no-fee program had $1 billion by then. But the participating funds must pay substantial fees — Schwab raised the ante to 35 basis points for incoming funds and to 38 basis points for a few institutional funds — which usually come right off their money management or 12b-1 fees. For some, like Montgomery Asset Management in San Francisco, the extra cost is actually lower than trying to direct-market funds themselves. But others passed up Schwab's "no-fee" distribution because of the cost. And such programs are growing because retail buyers want them.

The expensive consumer support that many funds have put in place since the market crashed in 1987 have had their price. "In terms of profitability on the public companies, 1985–'86 may have been a golden year," says A. Michael Lipper, president of the mutual fund ranking and analysis firm that bears his name. "Now there are more people on the phones who are better trained, more 24-hour services, consolidated statements, annual cost-basis reporting and more regulation," he says. "Our estimate of the cost of putting in consolidated statements for one group was six figures. When you're talking in basis points, that has an impact." Fidelity Investments poured $300 million into its fund business technologies in 1992 alone, the last year for which figures are available.

## Eroding expense ratios

Mutual fund expense ratios peaked in the mid-to-late '80s, according to Lipper Analytical. The worst price erosion has come in the fixed-income sector. "Probably half the fixed-income market is subsidizing its funds," says Lipper. Commoditylike

## Fee fall

The median expense ratio* for nearly every class of mutual fund has been declining since the mid-'80s.

| | General Equities | Int'l Equities | Sector Funds | Money Market Funds | Short Taxable | Intermediate Taxable | General Tax | Muni |
|---|---|---|---|---|---|---|---|---|
| **1983** | 0.93 | 1.21 | 0.98 | 0.71 | 1.04 | 0.78 | 0.86 | 0.75 |
| **1984** | 1.01 | 1.19 | 1.07 | 0.71 | 0.46 | 0.82 | 0.86 | 0.73 |
| **1985** | 1.03 | 1.34 | 1.10 | 0.70 | 0.91 | 0.81 | 0.86 | 0.79 |
| **1986** | 1.01 | 1.31 | 1.12 | 0.66 | 0.68 | 0.75 | 0.87 | 0.74 |
| **1987** | 1.12 | 1.45 | 1.35 | 0.65 | 0.60 | 0.86 | 0.98 | 0.76 |
| **1988** | 1.21 | 1.62 | 1.57 | 0.62 | 0.74 | 0.82 | 0.97 | 0.76 |
| **1989** | 1.22 | 1.53 | 1.48 | 0.61 | 0.76 | 0.82 | 0.99 | 0.77 |
| **1990** | 1.20 | 1.59 | 1.44 | 0.61 | 0.77 | 0.81 | 1.00 | 0.75 |
| **1991** | 1.22 | 1.72 | 1.43 | 0.59 | 0.79 | 0.78 | 0.97 | 0.72 |
| **1992** | 1.19 | 1.74 | 1.37 | 0.59 | 0.75 | 0.76 | 0.95 | 0.70 |
| **1993** | 1.18 | 1.63 | 1.26 | 0.59 | 0.75 | 0.79 | 0.95 | 0.72 |
| **1994** | 1.17 | 1.60 | 1.56 | 0.52 | 0.71 | 0.64 | 0.96 | 0.68 |

* *Expense ratios consist of money management, custodial and administrative fees (but not brokerage commissions) as a percentage of assets.*

Source: Lipper Analytical Services.

money market funds have suffered the most, with a sharp 27 percent decline in median expense ratios since 1983, to 52 basis points this year, according to Lipper Analytical. "There are still some high-fee money market funds," says Roger Servison, managing director of Fidelity Investments, "but the funds that are growing are the low-fee funds." In high-volume institutional money market funds, that translates into expense ratios of just 10 to 15 basis points a year.

Pricing on taxable intermediate-bond funds has fallen almost as sharply but faster, from 86 basis points in 1987 to 64 basis points this year. Overall fees on municipal bond funds fell 11.7 percent from their 1989 high, to 68 basis points this year. And that's measuring declines before accounting for the ravages of inflation (see table).

Contrary to popular opinion, equity funds are not immune. Median expense ratios at general equity funds, for example, have dropped 4 percent, to 117 basis points, this year since peaking in 1991, Lipper Analytical reports. And even the hot, supposedly high-margin international arena is under pressure. There expense ratios have dribbled down by 8 percent since 1992, to 160 basis points, despite an avalanche of expensive new offerings in the past two years. Once again, that's before factoring in inflation.

**"Three quarters of all 401(k) plan sponsors are paying too much."**

But for all the declines in retail market pricing, there's more to come. "I can assure you that there is tremendous pressure on the fee structure in the fund business," says Jack White, president of the San Diego discount brokerage firm.

On the distribution side some of the pain will undoubtedly come from White himself, who has already challenged the fee structure of rival Charles Schwab's distribution program. White thinks that the 25 to 38 basis points Schwab charges funds enrolled in its no-transaction-fee program are too much. His fees start at 20 basis points for funds with less than $10 million in the no-transaction-fee Mutual Fund Network program and drop to 10 basis points at $25 million. "We started out at a flat 20-basis-point charge," explains senior vice president Peter Mangan. "But we were excluding a lot of funds, like [Pacific Investment Management Co.], which could not participate at that price." Consequently, White's Mutual Fund Network has 500 retail funds available to buyers for no charge, compared with Schwab's 274.

White can charge less because he has lower overhead — only one office, in San Francisco, compared with Schwab's 205-office network nationwide. Although White has pulled less than one tenth the assets Schwab has into his no-fee program, it's already profitable, whereas Schwab reports that its fund program will reach breakeven only this year. Says White's Mangan, "We haven't spent much money on advertising or on radio and television, and despite the down market, we are growing at the same rate we were before." Eventually, of course, consumers who use these programs will want some of the cost savings passed on to them.

Much of the current profitability of the mutual fund industry can be credited to corporate America's rush to shift its retirement plans out of defined-benefit and into defined-contribution programs. Of the $2.1 trillion in mutual fund assets today, ICI reports that at least $553 billion is invested for retirement, 38 percent through defined-contribution and 401(k) programs.

But the expense for employees participating in most of these plans, compared with that for traditional defined-benefit plans, is outrageous. William Dougherty, a consultant at Kanon Bloch Carré in Boston, estimates that at least three quarters of defined-contribution-plan mutual fund assets are invested in fully priced retail funds. And retail funds cost at least twice as much as the average defined-benefit plan. Even the average institutional fund costs 50 basis points less than the average retail fund, Dougherty reports. In sum, three quarters of all 401(k) plan sponsors are paying too much.

Doubters should compare the costs themselves. The median equity fund now charges investors 117 basis points a year, and the median fixed-income fund, 84 basis points. That contrasts with just 37.9 basis points paid by the average big defined-benefit plan for everything from money management and administration to brokerage services — including asset oversight policy, performance measurement and consulting fees, according to Cost Effectiveness Measurement. And supposedly "expensive" actuarial work adds less than 1 basis point to that total. The cost for the "average" plan isn't much more, at only 39.5 basis points for money management plus roughly 10 basis points for administration, custody, actuarial work and brokerage fees.

The gap between the defined-benefit and defined-contribution numbers may not sound like much — it's only tens of basis points, after all — but it will mean a lot when baby boomer plan participants start to retire en masse. Shaving 50 basis points off the fees of an equity fund returning 8 percent a year would, over 30 years, add more than $12,400 to the account of even a modest $1,000-a-year saver, notes consultant Dougherty. And employees who dollar-cost-average to the $9,000 annual 401(k) maximum would see their savings increased by $111,834. For plan sponsors, 50 basis points could mean the difference between a group of contented retirees and a pack of 401(k) investors pouncing with lawsuits.

Raise these matters with most managers of mutual fund companies and they squeal in protest. "That argument is made by people who would like to see more money in defined-benefit programs," contends Robert Reynolds, president of Fidelity Institutional Retirement Services. "In defined contributions you have money coming in and out every day. If you added daily valuation into defined-benefit programs, the costs would be very similar." Even lower-cost T. Rowe Price Associates complains of the overall cost of administering its funds. "The company's expense growth has roughly paralleled the asset growth," says Kenneth Rutherford, assistant to the director of investment services at T. Rowe Price, which picked up one quarter of its $35.5 billion in assets through 401(k)s. "The economies of scale have not been there as we had hoped."

But the truth is that defined-contribution plans can cost far less to run than most major fund retailers want plan sponsors to believe, and a migration, however limited, away from full-retail plans has already begun. For example, IBM set up a trust for its 401(k) plan participants more than a decade ago, and to

share administrative costs, it began charging the trust fees in 1992. Now the company reports the cost of its defined-contribution program — including indexed money management, recordkeeping, access, communication and education — to be an average of only 15 basis points.

"As a fiduciary, we have a responsibility to keep costs low," says Arthur Amler, project manager of all the capital accumulation programs at IBM's Workforce Solutions unit, "and we are more hawkish than ever. So we are negotiating hard and leveraging the fact that we have 190,000 participants." American Airlines and General Electric Co. similarly grew disenchanted with the cost of retail funds and actually set up their own low-cost fund families.

At Vanguard, the ultimate low-cost retailer, the average expense ratio on some $40 billion in defined-contribution assets is only 30 basis points; recordkeeping adds only $10 to $50 per participant per year, depending on the size and the complexity of the plan. "Some plan sponsors look only at recordkeeping expenses, not the expense ratios that the plan participants pay," says James Gately, Vanguard's senior vice president of institutional sales.

Gately observes that companies are moving to alliance plans devised by firms like Wyatt Co., Hewitt Associates and William M. Mercer Inc. These allow the recordkeepers to offer 401(k)s with a half dozen different fund families, which rebate costs of 20 to 25 basis points to plan sponsors. As he points out, the rebates do reduce fees, but the plan sponsors — not the plan participants — get the benefit. Gately suspects that could become a big sore point once participants and regulators become aware of the problem.

"There is a lot of smoke on the 401(k) issue," complains Allan Martin, a managing director at Bankers Trust. "On savings plans you have a recordkeeping function that is not part of defined-benefit plans. The movement toward 401(k)s also allows participants to actively manage a component [of the plan], with the need for information and support and educational materials that they did not have before. So there is little doubt that defined-contribution [plans] cost more per dollar of investment than defined-benefit [plans].

"But mutual funds," Martin continues, "in one of the marketing coups of the ages, plunged into the 401(k) market and successfully persuaded unsophisticated human-resource-department plan sponsors that participants needed daily valuation and access to their funds, a wide range of funds and brand-name recognition. And [most] retail fund structures are expensive. If the poor plan participants ever bother to read what they paid for these services, they will not be happy." Daily valuation alone, he says, adds 10 to 12 basis points to the cost of managing money — but plan participants would do just as well with weekly or biweekly valuations that cost far less.

So far high-priced Fidelity has cleaned up in the 401(k) market — raking in more than $60 billion, mostly in the past three years — thanks largely to a program through which it forgives most if not all of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the recordkeeping charges to big corporations with lots of participants. (Fidelity is the savings-and-investment-plan provider for Capital Cities/ABC, the parent of *Institutional Investor.*) In this Fidelity is not alone. Competitors report that T. Rowe Price Investment Services, Dreyfus and most other major 401(k) providers also sell plans by touting free or cheap recordkeeping to plan sponsors — and make up the difference through the high-expense-ratio funds they put into the programs.

A flurry of new, institutional-strength funds aimed at the 401(k) market should alert expensive retailers that in the future the battle for market share cannot be fought on the basis of recordkeeping costs alone. For instance, AMT Capital Advisers, a fledgling boutique run by two former Morgan Stanley veterans — Alan Trager and Carla Dearing — raised $200 million in ten weeks after opening TIFF Investment Program for foundations, a series fund with five institutional portfolios.

Now Trager and Dearing are putting together a similar program for 401(k) plans. Says Trager: "Fund managers need sufficient fees to operate, and in negotiating with our managers, we geared our funds to grow to a certain size. Our overall costs are very low, ranging from 20 basis points on a large-cap index fund to 95 basis points for an actively managed international-equity fund. We are proud to be on the side of a fair, reasonable, advantageous fee schedule."

One hears a similar refrain from Regis Fund, which was started in 1989 to help market the institutional money managers working under the umbrella of United Asset Management. The 33 portfolios available through the series funds cost a total of only 20 to 90 basis points on all but the international portfolios, and they are selling nicely in the 401(k) market, says Regis Retirement Plan Services president Mary Rudie Barneby. "It's crazy for a company investing pooled assets of, say, $15 million to pay the same expense ratios as an individual with only $1,500 to $2,500," says Barneby. Others offering low-cost funds include Frank Russell Trust Co., Pimco, J.P. Morgan and Lazard Frères & Co.

Of course, mutual funds are not the only way to go. Principal's main arm is a mutual insurance company — and one of the largest providers of pension fund management for small and medium-size plans. Almost three quarters of the $32 billion in pension assets it manages are pooled in the company's general accounts. "We are in the lowest quartile on management fees," says pension service director Fitzgerrell. And his firm is growing fast in midsize 401(k)s, a market that the big funds find costly to cultivate.

So what does all this mean? Like it or not, fees in the defined-benefit market are under attack. And as defined-benefit managers move into the defined-contribution market to bolster their margins, they will find that the pressure is beginning to build there, too. "Pension plan sponsors are looking at costs because everyone is looking at costs," says Frank Russell Co. president and CEO Michael Phillips. "And the fact that the recession has ended has not ended the scrutiny of costs."

In money management, where fixed costs are high, variable costs are low, and incremental income drops straight to the bottom line, that can mean only one thing, Phillips concludes: slower growth and, eventually, lower profits. II


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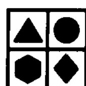

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