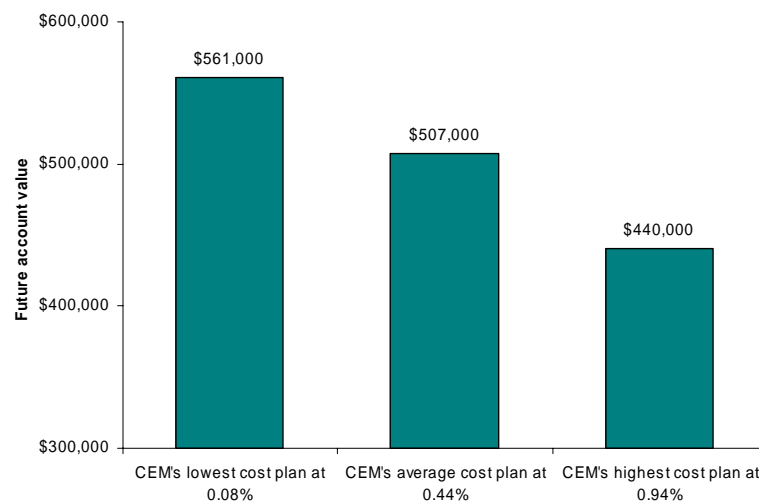


Costs Threaten Future Value

How does cost impact the future value of a participant's account? Small differences in cost produce large differences in future value. In 2004, the difference in total investment and administration cost between the lowest cost plan and the highest cost plan in the CEM defined contribution performance database was 0.86%. To put this difference in dollar terms, we projected a participant's account value over 30 years with the following assumptions: an initial account value of \$100,000, growing at a constant annual rate of 6%, and cost, as a percentage of account size, remaining the same. The account value of the plan with cost of 0.08%, which was the lowest cost plan in the CEM database, grew to \$561,000. The account value of the plan with cost of 0.94%, which was the highest cost plan in the CEM database, grew to \$440,000. This difference in cost reduced future value by 22%. The results are shown in Table 1.

Table 1:
Future Account Value in 30 Years for Plans in the CEM Database



The CEM database comprises plans that are much larger than the average pension plan. In 2004, there were 84 plans in CEM's defined contribution database. The average plan asset size was \$3.4 billion. The assets of several plans exceeded \$10 billion. These plans benefit from economies of scale. They are expected to be at the low end of the cost spectrum.

To observe the cost impact on future value in the typical small pension plan, we applied a representative cost from retail mutual funds to the model described above. According to Lipper, the average expense ratio for a US balanced mutual fund is 1.2%. At this cost level, the future value of our participant's \$100,000 account was \$408,000. Compared to CEM's lowest cost pension plan, the reduction in value was \$153,000 (\$561,000 less \$408,000) or 27%.

Costs threaten future value. The review highlights the importance of the cost monitoring function of fiduciaries.

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