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Investors clamor for ETFs in retirement account

Owners of IRAs, self-directed 401(k)s like the investments

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Investors who maintain self-directed 401(k) accounts or individual retirement accounts are increasing their investments in exchange traded funds.

Self-directed accounts allow investors to buy a range of equities and other securities, which sophisticated investors find appealing, financial advisers said.

"There are individual participants who are clamoring to get ETFs in 401(k) plans," said Tom Lydon, president of Global Trends Investments of Newport Beach, Calif.

In addition, investors are interested in adding ETFs to their IRAs, said Scott Burns, an analyst with Chicago-based Morningstar Inc.

While aggregate data on ETF holdings in IRAs isn't available, he thinks that investors will commit IRA assets to ETFs at the expense of mutual funds. In fact, Mr. Burns made that move with his own assets from a 401(k) plan that he moved into an IRA.

During the past year, advisers were introducing the concept of ETF investing in IRA accounts, and it has begun to catch on with clients.

Investors "are asking about them all of the time, and they want them added to their portfolios," said Kevin Mahn, chief investment officer at Hennion & Walsh Asset Management Inc. of Parsippany, N.J., which manages about $300 million.

ATTRACTING ASSETS

For their part, mutual fund companies are aware of the change in investors' attitude. Most of them now allow participants with self-directed brokerage accounts in their 401(k) plans to purchase ETFs, a decision that has attracted assets.

For instance, ETFs are held in about 6% of self-directed brokerage accounts at Merrill Lynch & Co. Inc. in New York, up from about 4% at the end of 2006.

At The Vanguard Group Inc. of Malvern, Pa., about 10% of participants hold ETFs through brokerage accounts in their 401(k) plans, up from about 6% since 2006.

ETFs now make up 22% of retirement assets within brokerage accounts at The Charles Schwab Corp. of San Francisco, which is up from 20% on June 30, 2007, Lindsay Tiles, a Schwab spokeswoman, wrote in an e-mail.

"We've been finding that these employees are increasingly interested in investing in ETFs, which are probably not available in the core part of their plan," she wrote.

To be sure, smaller plans offer ETFs on their platforms.

For instance, ePlan Services Inc. of Denver has 136 plans with more than $42 million in ETF assets. Just 18 months ago, there were zero assets in ETFs, said Mark Gutrich, president and chief executive of ePlan Services Inc., which has about $500 million under management.

"I think it is safe to say that there has been an increase in the level of interest among small 401(k) plans to use ETF products," he wrote in an e-mail.

Officials at State Street Global Advisors of Boston are awaiting approval for an ETF target date fund designed for 401(k) plans, said Anthony Rochte, senior managing director. "Clearly, in the 401(k) space, there's been an awful lot of demand."

ETFs may seem like a natural fit for IRAs, but there are obstacles that have slowed their adoption in 401(k) accounts in general, Mr. Mahn said.

For example, while conventional mutual funds carry higher costs than ETFs, their open-end structure is conducive to the regular, periodic purchases that are made for plan participants. ETF purchases, by contrast, carry commission charges, which mitigate the benefits of their lower costs.

In addition, 401(k) purchases often involve fractional shares, which are cumbersome with ETFs, and not all record keeping platforms can handle the product.

Many of these obstacles need to be addressed, said Luke J. Novak, a vice president at Chicago-based Rothschild Investment Corp., which supervises $2 billion in assets and celebrated its 100th anniversary recently.

In the meantime, he is hesitant to allow his clients to serve as guinea pigs.

"We don't want to be the first ones to try it out with our clients," Mr. Novak said.