

The High Cost of 401(k) Fees: How Much Are You Paying?

Hidden charges can rob you of a comfortable retirement. Learn how much you're paying.

By Mary Beth Franklin

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Any way you figure it, Steve Jeffers is a formidable investor. For 18 years now, the Belpre, Ohio, plant manager has been diligently stashing money in the 401(k) plan of his employer, Kraton Polymers. Thanks in part to a generous match by Kraton, the 43-year-old Jeffers has amassed almost \$400,000.

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Yet Jeffers didn't have a clue what his 401(k) investments were costing him -- and neither, we wager, do you. A recent AARP study found that more than 80% of 401(k) plan participants were unaware of how much they were paying in fees associated with their company's retirement savings plan. And what you don't know, you can't change.

Mutual fund returns in 401(k) plans are normally reported as net returns, meaning that fees for managing your investments are subtracted from your gains or added to your losses before calculating the annual return. Other costs, such as administrative and record-keeping fees, are often divvied up among plan participants but are not explicitly listed on individual investment statements.

This lack of transparency is frustrating for investors like Jeffers. He has concentrated his investments in global stock and bond funds that have significantly outperformed Standard & Poor's 500-stock index in recent years. "I don't mind paying fees if the returns justify it," Jeffers says. "But it would be nice to know what I'm paying."

That's not an easy question to answer, even for an investment professional such as David Loeper. "It

involves more than just looking at your statement," says Loeper, who heads an investment-consulting firm in Richmond, Va. "Under the expense column, my 401(k) statement said I was paying zero. But in reality, I was paying about \$1,500 a year on an account balance of about \$120,000, even though the bulk of my investments were in very low-cost index funds."

Once Loeper figured that out, he switched 401(k) providers for his small company of 25 employees to a less expensive vendor. He also wrote *Stop the 401(k) Rip-off!* (Bridgeway Books, \$15.95; 401kripoff.com) to help people like Jeffers figure out how much they're paying, whether the fees are fair and what to do if they're not.

1. Add fund expenses charged to your 401(k)

These charges, which go to the companies that manage your plan investments, are typically the largest 401(k) fees you pay.

To estimate your direct investment expenses, look for the expense ratio for each fund you own. That figure may be listed on your 401(k) plan Web site, or you can find it at kiplinger.com/tools/fundfinder. Expense ratios are expressed as an annual percentage of your total investments.

Next, grab your most recent 401(k) statement and record the expense ratio next to the balance in each fund you own. Multiply the expense ratio by your ending balance to determine the cost of each fund. For example, if you have \$10,000 in a fund with an expense ratio of 0.55%, you are paying \$55 a year. Add up the expenses for all of your funds.

A total expense ratio of 1% or less is reasonable. When we calculated Jeffers's fees, they totaled roughly \$4,000, or about 1% of his 401(k) balance.

If your 401(k) plan uses a broker or investment consultant, as many smaller plans do, you may be charged an additional 2% or more in portfolio-management fees. Teachers and other employees of nonprofit organizations who save for retirement through 403(b) plans may pay additional mortality charges and expenses to insurance companies, which typically provide annuities as investment options.

2. Determine if plan operating expenses are passed on to your 401(k)

You may also be paying your share of what it costs your employer to operate the 401(k) plan. Bigger companies often pick up plan expenses on behalf of their employees, but smaller employers can't always afford to do that. Still, for most 401(k) participants, the fees are less than they'd pay investing on their own, says David Wray, president of the Profit Sharing/401(k) Council of America.

Get a copy of your plan's summary annual report from your benefits office. Under the section labeled "basic financial statement," look for total plan expenses and subtract the amount of benefits paid. The difference is the plan's net administrative expenses.

Next compute your cost for administrative expenses, divide the net expenses (for instance, \$12,000) by the total value of the plan (let's say \$1.5 million). Multiply that percentage -- which is 0.8% (.008) in this example -- by your total account balance. That will give you your share of total

plan expenses that are deducted from your account before your individual balance is calculated.

3. Investigate undisclosed or hidden costs

You could be funding your boss's retirement or that of a colleague in the next cubicle without realizing it, says Loeper. That's what happens when your plan's service provider and individual mutual fund companies engage in "revenue sharing" arrangements. Such agreements are seldom disclosed; even your employer is unlikely to be aware of them.

For example, some high-cost funds may offer a rebate to the service provider to defray overall operating expenses. So the excess fees that you pay for your fund are used to pay the costs for everyone else in the plan. Or your plan's provider may receive commissions from mutual fund companies to steer participants into higher-cost funds.

How do 401(k) fees affect your bottom line?

With nearly 50 million U.S. workers depending on their 401(k) plans for future income, investment fees and related retirement-plan expenses are getting a lot of attention. In a 2006 report on 401(k) fees, the Government Accountability Office (GAO) concluded that such charges could "significantly decrease retirement savings."

Even a one-percentage-point difference in fees can have a big impact. For example, let's assume that a 35-year-old worker leaves \$20,000 in his 401(k) plan when he switches jobs and never adds to that account. If the account earned 7% a year, minus 0.5% in fees, his balance would grow to about \$132,000 at retirement. But if the fees were 1.5% annually, the average net return would be reduced to 5.5%, and the \$20,000 would grow to about \$100,000. Over 30 years, the additional charges whittle the account balance by nearly 25%. (Click here to [Roll Over Your High-Fee 401\(k\)](#))

Despite the potentially devastating impact of excessive fees, the U.S. Department of Labor received only ten complaints in 2005, indicating that few plan participants are concerned about or even aware of the problem.

The GAO report recommended that Congress require 401(k) plan sponsors to disclose fee information on each investment option to plan participants. (Legislation has been introduced in both the House and Senate.) The GAO also urged the Labor Department to require plan providers to disclose more information to employers, including revenue-sharing arrangements that may result in higher costs to 401(k) participants.

Although the Labor Department has issued proposed regulations to improve fee disclosures, they apply only to the employers who sponsor retirement plans and not to employees, who often bear the brunt of the overhead. The department is expected to issue another proposal soon detailing which 401(k) fees should be disclosed to plan participants.

If your 401(k) fees are too high . . .

If you think your plan fees are out of line, Loeper suggests that you contact your boss in a non-confrontational way, show how much you are paying in 401(k) expenses and ask if your plan could offer some lower-cost alternatives.

And spread the word to your colleagues. "Your one voice may not be enough," says Loeper. "But if your employer receives just a couple of additional questions from other employees, it's likely the company will wake up and take notice."

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