401(k) Plans Are Not Helping Employees Meet Their Retirement Goals

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NEW YORK (MainStreet) —Too many investors are still not saving enough for retirement, because their company 401(k) plan is charging high fees, hiding opportunity costs and offering intimidating websites.

The underlying problems associated with 401(k)s still need to be fixed, said Grant Easterbrook, co-founder of Dream Forward Financial, a new low-cost 401(k) plan based in NY.

"While 401(k)s are one of those complicated and confusing topics that people don't like to think about, they are very important because of the tax benefits and company matching programs," he said.

Americans Remain Unaware of Fees - While the incentives to invest in your 401(k) are strong, many employees are overwhelmed by the jargon or complexity of the websites. A recent video produced by Dream Forward demonstrated that very few average Americans even know who is managing their retirement account.

"Americans struggle to even name the firm who holds thousands of dollars of their net worth and their inability to understand the fees summarizes the problem pretty well," Easterbrook says in the video.

The impetus to save for retirement is being dwarfed by a lack of knowledge that is compounded by complicated websites and high fees.

"Shockingly, studies in the past have shown that 70% of plan participants think their 401(k) plan is free," said Mike Kane, CEO of Hedgeable, a New York-based robo advisor focusing on the downside protection in a bear market. "Isn't it time we provide a simple disclosure form to all plan participants once a year with one number on it, the total cost of the plan?"

Many plain vanilla 401(k) plans have fees that easily add up to 3% to 4% each year, but many employees are unaware of them because they are hidden.

"Dream Forward charges a flat 0.75% fee to all employees and no fees to the businesses," Easterbrook said. "We have total transparency on our site and no hidden fees."

Investors are more familiar with the fees imposed by 401(k) plans, which are "notorious for using very expensive mutual funds often because the plan sponsor or the employer receives a credit against the fees they pay to manage the plan from including these funds," said David Twibell, president of Custom Portfolio Group in Englewood, Colo.

“While we can’t control market returns, most investors can do a much better job of controlling the costs of their investments,” he said. “Using low-cost fund options and minimizing transaction costs are all fairly easy ways to keep more of your investment returns. While that may not seem important when the stock market is bounding higher, it is absolutely critical over longer-term market cycles.”

The fees “can eat up nearly 30% of your retirement savings over ten years, even a seemingly small annual fee such as 1.27%, which is the average U.S. mutual fund fee,” said Mitch Tuchman, managing director of Rebalance IRA in Palo Alto, Calif.

A second category of fees are those that are passed through to the participants by the employer and are often hidden. Many employees are not aware these hidden fees exist or that some asset managers sell their own funds in 401(k)s, which is a conflict of interest that is not always advertised, said Easterbrook.

401(k) fees can vary quite a bit because a company has wide latitude in deciding which fees to pass onto the participants, which are the employees, said Twibell. In some cases, the employer picks up all the fees, but more often than not, the employee foots most of the bill.

The average plan cost for a smaller company typically reaches 2.5% to 3%, said Kane.
“It's the millions of small businesses in America that get screwed in the 401(k) market,” he said. “Through technology integration, digital firms like Hedgeable can offer a plan to a small company at over half that cost."

The two fees can really add up and some employees end up paying over 2% in additional management and administrative fees, which is $2,000 in unnecessary fees on a $100,000 retirement account each year, Twibell said.

Options For Employees - Companies should offer employees a diversified choice of alternatives with different levels of risk, said Don Shelly, a finance professor at Southern Methodist University’s Cox School of Business in Dallas.

“Two few funds lead to the charge that the company provides an inadequate set of investments,” he said. “Too many can lead to confusion and excess costs.”

Most employers now provide low-fee index funds as an option in their 401(k) plans as the trend has shifted from actively managed to passive index funds, which have lower expense ratios. Studies have demonstrated that most active managers fail to beat indexes, Shelly said.

The average employee should invest time into his retirement options and learn the basics about investing such as stocks, bonds, diversification, risk and return, he said.
“The cliché that people spend more time planning their vacation than planning for their retirement is largely true,” Shelly said.

Delve into the nuts and bolts of your employer’s plan to see what alternatives are offered. Make a plan to attend the information sessions provided by the company or its plan administrator, he said.

Compare the expense ratios for the funds offered in your plan with industry averages. You can check them against Morningstar and several other sources.

"Don't pass the buck," Shelly said. "It's your money, so take responsibility and expect accountability."

Additional reform is needed in the industry because it has robbed average investors of larger returns.

"Maybe it is time we blow up the 401(k) rules and start from scratch," Kane said. "There are too many hands in the cookie jar, too many layers of fees and too many regulations. Why not simply give all employees control to invest their 401(k) however they like? Here is up to $18,000 from your paycheck, now go invest, with no fees. Instead of 3% in fees, some participants could be investing for free."