Shining light on 401(k) fees

Plan's expenses crucial; disclosure rules expected to spur lower-cost options

BY PAMELA YIP
The Dallas Morning News

More and more companies are switching to defined-contribution plans, such as 401(k)s, and ditching traditional pension plans.

That means that how much money you end up with for retirement depends entirely on how well you have invested.

Unfortunately, many participants in 401(k) plans don't even bother opening their account statements.

That's bad.

You should always have an idea of how your investments are doing. Don't invest and then morph into an ostrich.

Now investors have another good reason to open their statements — because of new rules that took effect July 1, they'll be able to clearly see what fees their 401(k) plan is paying.

That's critical because fees and expenses may "substantially reduce the growth in your account," according to the U.S. Department of Labor, which developed the rules.

Under the new rules, investment companies and record keepers who manage 401(k) plans will be required to disclose all fees to employers who offer such plans. Employees will start seeing the fee figures in their third-quarter account statements.

"This is one of the most important rules for the modern 401(k)," said Tim Kohn, head of defined contribution services at Dimensional Fund Advisors, which manages assets for institutional investors and clients of registered financial advisers.

"For most workers, the information will be available for the first time," Kohn said. "It's been random and sporadic, depending on the record keeper and the investment manager,

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but there has been no standardization requirement until July 1."

He also expects 401(k) account holders to see more lower-cost options as a result of the disclosure rules.

"Almost half of employers are looking to add low-cost investments to their lineup because of this rule," Kohn said.

If you don't think 401(k) fees matter, think again. They can make a huge difference in your account's balance.

For example, assume that you are an employee with 35 years until retirement and a current 401(k) account balance of $25,000.

"If returns on investments in your account over the next 35 years average 7 percent and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to $227,000 at retirement, even if there are no further contributions to your account," the Labor Department said. "If fees and expenses are 1.5 percent, however, your account balance will grow to only $163,000."

In this case, a difference of 1 percentage point would reduce your account balance at retirement by a whopping 28 percent.

"Investors are often inclined to underrate the importance of investment expenses, because they're these innocuous-looking little percentages," said Christine Benz, director of personal finance at Morningstar, which researches mutual funds. "But costs are such an important consideration when making investment decisions.

"Not only are they very impactful when compounded over time, but they also fall into that fairly small category of factors that investors exert some level of control over. To the extent that these new disclosures get investors to plug into how much they're paying, that's a good thing," she said.

Under the Labor Department's new rules, 401(k) plans will be required to disclose any fees or expenses for general plan administrative services, such as legal, accounting and record-keeping services.

They also must disclose fees and expenses that may be charged if you use special features of the plan, such as taking out a loan from your 401(k).

And they must disclose all investment-related fees. Pay particular attention to these fees.

"By far the largest component of 401(k) plan fees and expenses is associated with managing plan investments," the Labor Department said.

Fees for investment management and other investment-related services generally are assessed as a percentage of assets invested.

"You should pay attention to these fees," the Labor Department said. "You pay for them in the form of an indirect charge against your account because they are deducted directly from your investment returns. Your net total return is your return after these fees have been deducted."

The rules will make workers better-informed investors, Benz said.

"While much of this information was available before, it wasn't as accessible as it will be with the new disclosure rules," she said. "If employees scrutinize this information and feel that they're paying too much, they might be motivated to tell their employers they'd like to see lower-cost options or invest outside the confines of their 401(k)s, in a Roth IRA, for example."

Still, while fees are important to consider, they shouldn't be your sole focus when it comes to your 401(k) plan.

The real key is to save.

"Saving more money will make 10 times more difference than saving half or quarter of a percent (in fee and expenses)," said Charlie Epstein, founder of the 401k Coach program.