

MoneyWise

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Geoffrey S. Huber COMMENTARY

Guest column by Geoffrey Huber: Are fees dragging down your 401(k) returns?

If you work for a small to midsized company whose 401(k) is administered by a bank or insurance company, you may be getting taken advantage of.

A bold statement? Consider these real life examples — cases we've worked on recently:

- Company No. 1, 85 employees: The firm started a 401(k) plan through a well-known insurance company about 10 years ago. The plan assets are about \$1 million. Upon review, we were able to demonstrate to the client their total plan fees were 2.22 percent of the plan assets, or more than \$22,000 per year.

"How can this be," a company executive asked, "since we're only paying the insurance company \$1,250 per year?"

We demonstrated their direct-billed expenses — those they could see — were \$1,250 per year. Yet this was only 5 percent of their overall fees! The other 95 percent was netted from investment returns, thus invisible.

Out of sight, out of mind, and out of your pocket.

- Company No. 2, with 55 employees: The firm started a 401(k) plan through a well-known bank about 12 years ago. The plan assets are about \$1.25 million. The total plan fees are about 2.71 percent of plan assets — all but \$1,850 being netted from plan assets.

Why should you care? I'll give you \$175,000 reasons!

The hefty fees are dragging down your investment returns. This is costing you money, in the form of punier-than-need-be account balances upon reaching your retirement age.

Consider another example of a 35-year-old employee earning \$50,000 per year.

Assume she has a \$10,000 retirement account balance, and contributes 10 percent of her gross income per year, pretax, into her employer's 401(k) plan. Her employer kicks in 3 percent of her gross wages in the form of matching contributions or profit sharing, so her total contributions equal 13 percent of her gross pay.

Next, as a moderately aggressive investor, she can earn a 9 percent gross investment return (i.e., before any plan-level fees) on her growing balance.

Presuming her employer's plan carries expenses of 2.5 percent of plan assets, this means her investments are growing at a rate of 6.5 percent annually (9 percent gross return less 2.5 percent expenses). Thus her future value at her normal retirement age of 67 equals \$616,369.

But what if her company thoughtfully chose a plan with lower fees — say 1.25 percent of plan assets?

Then, her balance is growing at a 7.75 percent clip, net of plan expenses. If so, her expected balance at age 67 equals \$791,235. A difference of \$174,866!

The bottom line: For years, standard operating procedure was for 401(k) providers to mask fees — and to sweep the discussion under the table. Since this is your money, we believe vehemently that you deserve to know what your plan costs.

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