Beware of the High Fees in 401(k) Plans

High annual 401(k) fees hurt your investment returns every single year

Remember when 401(k) sounded like something only a chemist knew about? Now we all receive 401(k) statements routinely – including information about fees. Here's what to do if the fees rise.

When 401(k) plans' fees hit 2% annually, they introduce a tremendous drag on your investment returns over the long term.

Overall cost of your 401(k) plan hinges on two components. The first, and easiest to find: the internal expense ratios of the plan's investments, a measure of what it costs an investment company to operate a fund. Data from Morningstar shows that these fees generally range from about 0.5% to 1.5% or more.

The second part of the costs: the additional fees that the 401(k) plan administrator negotiates with a brokerage or third-party administrator to manage the plan. The Department of Labor estimates that these fees also generally range from 0.5% to about 1.5%.

When combined, these fees could amount to nearly 3% for some smaller 401(k) plans. Larger employers' plan fees average about one percentage point less, at approximately 2% per year, at least according to the DOL.

Do You Have an Extra 2 Years?

For example, if your investment returns average 8%, that doubles your investments (on average) every nine years. A mere 1% fee deducted from the average investment return means doubling takes a bit more than 10 years. A 2% fee brings you down to a 6% net average return, so now your account won't double until 12 years.

If you started with $10,000 in your account, this results in a differential of more than $42,000 over 30 years: At 8% your account grows to $100,627 and grows to only $57,435 at a 6% return.

Things to Do

Participants have access to plan-level fees so you can learn more about the overall fees charged to your plan. With this extra information, you can improve your returns and control some exposure to investment fees.

A few of your possible moves:

- Lobby for lower fees. Ask your human resources representative if your plan offers lower-cost options. Index funds in a 401(k) plan produce similar investment results as do often high-cost managed mutual funds, with much lower expense ratios.
- Take in-service distributions. If your plan allows distributions while you're still employed, roll over some or all of your account to an individual retirement account and then choose lower-cost investment options. Typically, a 401(k) plan offers this option only to employees at least 59½ years old; but not all plans offer in-service distributions.
- Balance high-fee options with lower-cost options outside the plan. If your plan comes with unusually high costs, invest the bulk of

your retirement funds in accounts outside the 401(k) plan, such as in an IRA or Roth IRA, if possible.

- Review the investment options in your plan for diamonds in the rough, such as certain institutional funds with very low expenses and high minimum investments.

Of course sometimes leaving your money in a 401(k) plan – even with high expenses – makes sense. For instance, you can’t take a loan from an IRA, as you can from a 401(k).

No matter what you do, make sure your 401(k) works for you.