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# 10 Things 401(k) Plans Won't Tell You

How out-of-control fees and below-par investment options could delay your retirement -- or rob you of it entirely.

By ELIZABETH O'BRIEN

## 1. We weren't meant to carry the weight of your future.

For more and more Americans, the quality of one's retirement comes down to the quality of one's 401(k).

That's a lot of pressure to put on plans that started out as a source of extra cash for individuals who were already guaranteed a secure monthly retirement income. When 401(k)s were first introduced in the late 1970s, most workers still had "defined benefit" pensions -- retirement plans where employers made all the decisions about what to invest where. Back then, 401(k)s were intended as mere supplements to those plans, says Lee Topley, managing director of the retirement plan consulting group at Unified Trust, a Lexington, Ky., firm that manages the needs of plan participants on behalf of employers. Early contributors to 401(k) plans were mostly high earners, since they had the biggest tax bill and thus the greatest incentive to sock away pretax dollars in the plans, says Greg Carpenter, CEO of Employee Fiduciary, an independent administrator of 401(k) plans.

The double-digit interest rates of the early 1980s made it relatively easy for

companies to meet their obligations through low-risk bonds, Topley says, but pensions became more expensive for companies as interest rates began to fall and plans had to project for even lower rates in the future. From then on, 401(k) plans, known in the industry as "defined contribution" plans -- where the financial burden is placed squarely on the employee -- continued to grow, as more companies decided that pensions were too pricey to continue. Today, 401(k)s hold $3.5 trillion of retirement assets, and only 7% of private sector employees with retirement benefits had a pension in 2008, down exponentially from 62% in 1980.

## 2. We have no clue how much cash you'll need in retirement....

When it comes to actually figuring out how much to save to live a comfortable retirement, most workers are on their own. And once they stop working, it's up to workers to figure out how to turn their nest egg into an income stream. Only 28% of employers offer automatic projections of how much retirement income a participant's 401(k) account might produce, according to a study done earlier this year by MetLife.

Instead of providing information particular to a worker's plan, employers tend to offer online tools to help participants prepare their own retirement income projections. But few workers have enthusiastically embraced the challenge of doing this themselves. Employers "spend all this money on education and tools, and everyone's just using automatic features" like the default option, says Robyn Credico, a defined-contribution specialist for Towers Watson, a benefits consultancy.

## 3... and figuring it out isn't high on our agenda.

Nearly three-quarters of large employers surveyed this year by Towers Watson say they offer a 401(k) plan to help provide for workers' income in retirement. But when companies were asked to name the top issues driving plan design, workers' ability to retire came in fifth, behind the competitiveness of benefits within the industry, benefit plan costs, employee attraction and retention, and legislation and compliance. What gives? "It's a struggle" for companies to design a competitive plan on a limited budget, Credico says. The burden on employees to provide for their own financial security is huge, and the best advice companies can give is simply to encourage

their workers to save, she notes. As an incentive, 91% of the companies surveyed by Towers Watson -- each of which had more than 1,000 employees -- offered matching contributions. Of those, nearly a quarter offered non-matching contributions, meaning the company would set aside money even if the employee didn't. Still, we're not talking big bucks: according to the Plan Sponsor Council of America, a trade group representing employers who offer retirement plans, the average company contribution to 401(k) plans is 2.5% of pay -- not nearly enough to provide for the basic costs of living in retirement.

## 4. The system isn't working for employees -- or employers.

The aggregate retirement income deficit for all Baby Boomers and Gen Xers -- that is, the amount by which their savings, plus Social Security, fall short of what they'll need -- is $4.3 trillion, according to the Employee Benefit Research Institute. Clearly, folks aren't setting aside enough for their post-work lives. The average employee contributes 6.4% of her paycheck to her 401(k),according to the Plan Sponsor Council of America. Advisers recommend 10% as a baseline minimum, and for those who start late (in their 40s or even 50s), 15%.

The problem's not just one for workers, though. Post financial crisis, companies have noticed a rise in so-called "hidden pensioners," Credico says. These are individuals who can't afford to retire, but they check out on the job. Plenty of older folks enjoy the stimulation of work, but hidden pensioners punch the clock for a paycheck alone, and their performance suffers for it. The good news is that these laggards are spurring companies to design more effective retirement plans, Credico says -- a self-serving motivation, for sure, but at least it's ultimately to participants' benefit.

## 5. Fee transparency? What fee transparency?

New Department of Labor regulations went into effect this year requiring plan providers to disclose the amount in fees that both companies and their workers pay for their 401(k) plans. The intention was to shed light on notoriously murky 401(k) fees. It's one of the few instances where the consumer of the product--both employers and employees alike -- often have little idea what they're paying for,

thanks to buried fees. For example, a fund's "expense ratio" can encompass everything from marketing fees paid to the investment firm to commissions paid to the broker who recommends particular funds.

Disclosure notices went out to employers in the spring and summer; employees got their first disclosures over the summer and this month will receive their first quarterly statements under the new disclosure rules, which will itemize fees deducted from their plan. But critics have been disappointed with the first round. Some statements "disclosed" a wide range of fees, as in "your expenses range from 0.25% to 2%," leaving companies wondering where exactly their fees stood. What's more, the fees came without any guideposts on industry averages. So even if a company was told it paid, say, 1.25%, executives would have no idea how those fees stacked up against other plans. This is no accident, critics charge. "They didn't try to make it plain English and fail," Employee Fiduciary's Carpenter says. "They complied with the letter of the law and made it as gibberishy as possible." To be sure, some say, it'd be very difficult to arrive an at "average" 401(k) fee, since there are so many variables, including number of plan participants and type of investments.

## 6. You're losing years' worth of savings to fees

Take for example a portfolio that says its fee is 1%, a number that wouldn't be uncommon. That may not sound like a whole lot. But when it's chipped annually from your retirement nest egg, the cumulative effect can be significant. A worker who makes $75,000 per year and saves 8% of that annually in a 401(k)would lose 2.8 years' worth of savings in a target-date fund with a 0.2% fee and 11.6 years in one with a 1% fee, over the course of a career, according to an analysis by Towers Watson. The new DOL fee disclosures were designed to open individual participants' eyes to this kind of impact, but for now, they're mainly raising eyebrows mainly among savvy employers, Topley says.

## 7. but things are starting to improve.

The Department of Labor's spotlight on fees has already pushed plan providers to offer lower-cost options, such as exchange-traded funds, in 401(k)s. Some, like Schwab, rolled out new offerings earlier this year, before the first disclosures came

out. "This is the true trickle down," says Mike Alfred, CEO and co-founder of 401(k) consulting firm BrightScope. So while plan participants might not take to the streets after seeing how much they're paying for their 401(k) -- disclosures are hardly going to change the prevailing apathy -- their employers are getting wise to the expenses, and they're starting to demand better options.

Indeed, companies' awareness of 401(k) fees has increased sharply over the past five years, insiders say, and the disclosures may spur further eye-opening. Part of this awareness has come from lawsuits filed against both employers and investment firms over 401(k) expenses. Many of the lawsuits have centered on share classes, forcing plan providers to explain why they're using an expensive share class when a lower-cost option is available.

## 8. Fewer choices doesn't mean better ones.

Just as drug stores have pruned their shampoo offerings to prevent shoppers from getting overwhelmed, plan providers have recently reduced the number of fund options in 401(k) plans. The number of large employers that offer 20 or more funds declined by 8% from 2010 to 2012, and the number of sponsors that offer nine options or fewer increased by 3%, according to Towers Watson. This is generally a good thing, experts say, since too much choice can indeed lead to consumer paralysis.

But the choices that remain are still too expensive overall, consumer advocates agree. The average plan has approximately 60% of assets in stocks, according to the Plan Sponsor Council of America. Twenty-five percent of assets are invested in actively managed U.S. stock funds and just 9% are in indexed U.S. stock funds. Actively managed funds, where a fund manager picks stocks in an attempt to beat the market, are more expensive than passive index funds that aim only to mimic market returns.

"Most people will be better off in indexed funds with costs as low as possible," says Steve Vernon, president of Rest-of-Life Communications, a benefits consulting firm. But brokers who advise companies on plans often don't have an incentive to choose the lowest-cost option, since they get compensated through commissions paid out

by investment firms for pricier share classes. Companies often don't realize this and think their broker's advice is "free," since the compensation fee is bundled into the expense ratio, even under the new DOL fee disclosures.

## 9. Small business employees are missing out.

Just half of workers in companies with fewer than 100 employees have access to retirement accounts, according to the Bureau of Labor Statistics, compared with 79% of workers in companies with up to 499 workers, and 86% of workers in large companies. "They're still not reaching enough workers," says Chad Parks, founder and CEO of The Online 401(k), a provider of 401(k) solutions for small businesses.

When they do have 401(k)s, small company employees are likely to pay more for them than their counterparts at big firms, for a number of reasons. Some can be legit: many advisers who consult on 401(k)s get paid a percentage of the plan's assets, and they need to charge a larger percentage for a plan with fewer assets. And with a small plan, the administrative costs are spread out among fewer people. But this is sometimes taken too far, Parks charges. Some small businesses pay as much as 2.5% for a basic 401(k), he notes. Another reason why small businesses get stuck with a bigger bill is because they often don't have investment committees who scrutinize the plan on behalf of their fellow employees.

## 10. Autoenrollment alone won't save you.

Automatic enrollment has risen in recent years, placing employees in 401(k) plans even if they don't opt in. Nearly a quarter of large firms offered auto-enrollment to all employees in 2012, up from just 10% in 2009, according to Towers Watson. While it's good that employees are forced to save(few who are auto-enrolled bother to opt out), employee advocates say, they're not saving as much as they should. That's because companies often deliberately set the default contribution rate low -- generally around 3% of pay -- so they don't have to match as much, Credico says. Of course, employees can always change their default rate, but few bother.

Indeed, many workers don't even know their contribution rate. Vernon conducts regular workshops with plan participants. Recently, he's been askingroomfuls of

them how many read the fee disclosures they gotover the summer, and invariably only one or two hands go up, he says. This isn't necessarily bad news if those few are vocal staffers who can educate and motivate their fellow employees. But really, no one can afford to be complacent when it comes to planning for retirement, Vernon says: "People vastly underestimate how much money it takes to have a lifetime income."

NEXT

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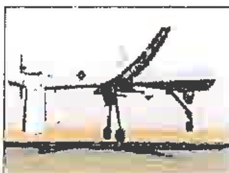

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