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## Big Fees Take Their Toll On Startup 401(k) Plans

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Two years ago, Brent Breaux became suspicious about his wife's 401(k) retirement plan: Account statements showed she was somehow losing money on an investment in a super-safe money-market fund.

The culprit, the Houston technology consultant found, was the high fees associated with his wife's retirement plan. "I wish my wife could move her 401(k)," says Mr. Breaux.

The retirement savings of millions of Americans are being seriously eroded because of the high fees charged to administer their 401(k) plans. Most at risk are employees of small companies. Studies show that many participants in 401(k) plans sponsored by companies with fewer than 50 employees pay far more in fees than their large-company peers.

Investors in 50-person plans pay an average of 1.4% of their assets annually in fees, or about \$14 for every \$1,000 invested -- assuming an average participant balance of \$40,000 -- according to a new study by HR Investment Consultants in Baltimore. That compares with 1.17% for investors in 1,000-person plans. But many investors in small plans pay as much as 3% or more, according to HR.

That could mean a significant difference to participants over time. Over 20 years, a 1% increase in fees on a \$100,000 investment can reduce the portfolio's ultimate gain by \$66,254, assuming annual investment returns of 7%. And fees can take a particularly large bite out of an investor's annual return when investment returns are low, as Mr. Breaux found out with his wife's money-market fund.

Small retirement plans are more vulnerable to paying higher fees for several reasons. One is that they aren't able to spread the costs of a running a 401(k) -- including legal compliance, shareholder communications and recordkeeping -- across as many participants as large plans.

Smaller companies also have a less attractive choice of investment options. Many smaller plans are built around pricey group-annuity contracts issued by insurance companies, whereas many big-company 401(k)s utilize lower-cost mutual funds. Mutual-fund companies, which typically generate their retirement-plan profits from the assets invested in their mutual funds, tend to shun small plans. The

smaller the plan, the less likely it is to be profitable. The low-cost zealots at Vanguard Group, for instance, typically won't take on plans that have less than \$3 million in assets, according to a spokesman.

Spurned by big institutions, many small-business owners frequently turn to their own stockbrokers and insurance agents to set up plans for their companies. For their services, those brokers and agents, who sometimes set their own pay, often charge higher fees.

The problem affects a significant percentage of the work force. Of the 400,000 companies with 401(k) plans, nearly three-quarters are plans with fewer than 50 participants, according to the Society of Professional Administrators and Recordkeepers. The 401(k) retirement plans sponsored by such firms hold \$192 billion in assets.

Not all fund companies have shied away from this market. Fidelity Investments, for instance, offers an online plan -- "e401k" -- that allows employers to keep costs relatively low, although it limits the services available to employees, such as the ability to get assistance with their investments over the phone. Fidelity charges employers \$3,000 for the complete service, which the employer can pay or pass along to employees. The only other charges paid by participants are Fidelity's fund-management fees, which typically range from 0.19% to 1.2%.

Other companies that offer low-cost, online 401(k)s include Principal Financial and Decimal Inc.'s the Online 401(k), which sets up defined-contribution plans using Charles Schwab Corp.'s brokerage services.

The plan in which Mr. Breaux's wife participates is a group annuity run by Manulife Financial Corp. Investors in these plans allocate their money among numerous "subaccounts" or "funds," which in turn invest in the shares of regular mutual funds. A key tipoff that your 401(k) plan is a group annuity: Your holdings are listed as "units" of a subaccount rather than "shares" of a regular mutual fund.

Like all mutual funds, these annuity portfolios are charged fees for investment management and other costs of doing business. But Mr. Breaux found his wife was paying additional charges for her 401(k) as well: A statement for the three months ended June 30, for instance, shows two separate charges, identified only as "fees," which add up to about 1.2% of her invested assets a year -- on top of fund fees such as a 0.6% fee on the money-market offering. Those added expenses explain how a barely positive investment in a low-yielding money-market fund became a money loser.

Mr. Breaux didn't realize his wife's plan was an annuity, and was puzzled as to why the funds in which she invests aren't ordinary mutual funds that he can look up in a newspaper. (He declined to identify his wife's employer but said it is a small company with about 30 employees.)

Paul Henry, director of strategic planning for Manulife's retirement-services unit, says he can't discuss a particular client. But he says quarterly charges appearing on a 401(k) statement typically compensate a retirement-plan administrator and a financial adviser involved with the plan, not Manulife itself. Those business relationships and fees are negotiated by the employer, he says, and the employer also decides how much information participants receive about those charges.

How can employees take action to fix their plans? The chief thing they can do is make their employers aware that fees are a concern. Once an employer is alerted to the issue, there are a growing number of consultants who will examine plans to see if participants are being overcharged.

One such site, [401khelpcenter.com](http://401khelpcenter.com), has a section devoted to fees, including a list of questions employers sponsoring plans should be asking about fees. In April, a company called Pension Tech Solutions launched a Web site ([www.ptolutionsllc.com](http://www.ptolutionsllc.com)) where 401(k) plans, for a relatively small fee, have their plans' fees analyzed by filling out an online questionnaire. And the U.S. Labor Department, which regulates retirement plans, has created an online guide to 401(k) fees available at [www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html).

American Fibers & Yarns Co., a Chapel Hill, N.C., maker of synthetic yarn, this spring hired a consultant to decipher the costs of its plan, which has \$6 million in assets and 450 participants. The consultant discovered employees were paying annual fees of about 3.3% on their retirement-plan investments, almost three times the fees of the average plan of similar size.

One big reason for the high fees: The broker was earning more than 1% of the plan's assets in the form of commissions each year, or roughly \$60,000 a year.

American Fibers this summer fired the broker on the plan and has reduced its plan's annual fees to under 2%. Jake Mays, chief financial officer at American Fibers, says the company's financial agreement with its plan's provider, Nationwide Financial Services Inc., didn't change as a result of the change. Mr. Mays says the company is exploring further changes to the plan in hopes of generating additional savings.

A spokesman for Nationwide says the bulk of the fees charged on many plans is determined by arrangements the plan sponsor makes with brokers and administrators. The spokesman said that Nationwide "receives only a small portion of overall plan fees."

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