



The Fee War: The Impact of Fees on a Participant's Future Benefits

Chris Carosa, of the Fiduciary News Blog, recently wrote about an ongoing industry conversation that he refers to as a "401(k) Fee War." In this article, Chris references the significant attention being paid to mutual fund expenses for 401(k) investment options. As an industry observer, I too have noticed that the attention being paid to mutual funds fees as well as other asset-based charges assessed to participants has increased dramatically in recent months.

In his article, Chris reminds his readers that the assessed fees associated with servicing a retirement plan need to be reasonable. Chris also points out the current lack of specific regulations on these fees. That being said, retirement plan sponsors are wise to pay attention to the fees being assessed by fund complexes and other professional service providers to their participants.

My intended audience for this article is not professional advisors, such as myself, who are obsessed with the pension market and monitoring trends on a weekly basis, but rather company owners who are otherwise busy professionals with limited time to dedicate to company sponsored benefits. Because my readers may not be familiar with the details of ERISA (Employee

Retirement Income Security Act) and the fiduciary duties that are required of retirement plan sponsors, I thought it would be useful to provide a real world example of the impact these can have on a participant's future retirement benefits. Realistically, even small variances in asset-based charges assessed to participant account balances can have a significant impact on a participant's future benefit.

For example, assume that two participants each contribute \$250 per month to the same 401(k) investments. The only difference is the net rate of return available to each respective participant. For this example, investor A earns 8% and investor B earns 7.5% because investor B purchased mutual funds that have higher expense ratios. Based on these assumptions, investor A will have \$239,342 at the end of a 25 year period of time. Investor B, who earned 7.5% over the same 25 year period, will have \$220,686. As you can see, paying an additional 0.50% over that 25 year period resulted in investor B ending up with \$18,656 less than investor A.

You can take this example an additional step forward by examining the difference in future benefits for these two participants due to the difference in their

account balances at retirement. Assume, for example, that they each draw down their respective portfolios over a 20 year period at a 7% rate of return. Investor A could draw almost \$150 per month more than investor B. Over this 20 year retirement the total difference in benefit is more than \$30,000. For many retirees this is a meaningful number.

If you start to apply this thought process across multiple participant accounts, you can begin to appreciate why it is so important for plan sponsors to pay attention to the underlying expenses assessed against their participants. Clearly, not all investment expenses are bad or imprudent. However, if the same or comparable investment options are available less expensively, then plan sponsors should take action to reduce those costs.

In conclusion, the "401(k) Fee War" is likely to rage on. Unfortunately for plan sponsors, remaining neutral will not be an option. Fees impact participant performance and subsequent retirement benefits. Consequently, plan sponsors need to pay careful attention to the cost associated with providing investments and other services to participants.



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