

# What Makes a Good 401(k) Plan?

**Chapter**

**Four**

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Are you looking for a new job? If you're deciding among a few opportunities, you may also want to consider the quality of each employer's retirement plans. There is no standard plan—each company creates their own features, and some are better than others.

You may be happy with your current employer and just curious to know if your plan is up to snuff. Or you may be a plan sponsor who wants to know which cutting-edge features to consider for your plan.

Here's a guide to the features of today's best 401(k) plans.

## ***Employer Contribution***

An employer contribution is the single most important 401(k) plan feature. To achieve an adequate level of retirement income, you need to save at least 10% of your income each year. The more you get from your employer, the less you have to save.

Any employer contribution needs to be considered—not just a 401(k) match. This includes an employer-funded pension benefit and the many other types of employer contributions. Unfortunately, many different names are used to describe the same type of employer contribution—making comparisons difficult. The following is a brief summary of the different types of employer plans and contributions.

**Traditional Defined Benefit (DB) Pension:** This is the kind of retirement benefit your grandfather probably received each month of his retirement. There are still some of those critters around, but they're a dying breed. These plans are typically worth less than 1% of your pay in your 20s, about 1% in your 30s, 3% in your 40s and 5% or more in your 50s. These percentages of pay are approximate amounts employers must contribute to this type of plan.

If you leave the company, you receive a frozen benefit based upon your final salary. DB plans aren't very valuable unless participants spend most of their careers with the same employer.

**Cash Balance Pension:** This is a modified version of the traditional defined benefit plan. In this case, the employer contribution is usually a specific percentage—typically between 3 and 5% of pay. Your current benefit value is equal to the percentage of pay that your employer contributes.

**Employer Non-Matching Contribution:** There are many different types of defined contribution or "DC" plans. The employer contributes a specific or variable percentage of pay each year. This type of contribution may be included in a 401(k), 403(b), defined contribution/money purchase pension, employee stock ownership, 401(a), Keough, Simplified Employer Plan, profit-sharing or SIMPLE-IRA plan.

The amount of the employer contribution could be as small as 1% of pay or as much as 25%. The one common characteristic among all these plans is that you do not have to contribute to get the employer contribution. And in all cases your benefit value is equal to the employer contribution.

**Employer Matching Contribution:** This is the most common type of 401(k) employer contribution. But employees get the employer contribution only if they also contribute to the plan. An employer matching contribution may also be part of a 403(b) or SIMPLE plan.

Typically, only a portion of the amount you contribute is matched. The benefit value is equal

to the percentage of pay your employer contributes. You maximize the value by contributing the full amount that your employer will match.

The matching contribution may be the only employer contribution, or it may be in addition to an automatic or variable employer profit-sharing contribution. For example, your employer may automatically contribute 3% of each eligible employee's pay plus a 25 or 50 cent matching contribution.

Employers are not required to have any retirement plan and they are not required to contribute to a 401(k) plan. Employers that do so are making a financial commitment to help you save for retirement.

The level of the employer's contribution is a strong indication of the company's culture and financial strength. For example, in *Employee Benefits News* I read about the SAS Institute, the largest privately owned software company in the world with 7,700 employees. The company has contributed 15% of each eligible employee's pay to a profit-sharing plan for the past 25 years. You don't have to worry about contributing to a 401(k) plan if your employer already contributes 15% to a plan for you.

When you evaluate your employer's retirement plan, don't just look at the 401(k) company match. If the SAS employees did that, they would think they worked for a lousy company because they don't have a 401(k). Obviously, any plan that includes a 15% employer contribution is a lot better than a 401(k)—even one that has a dollar-for-dollar employer matching contribution.

Employees and writers for financial publications often make the mistake of focusing only on the 401(k)—overlooking the many other types of employer contributions. This prevents "apples to

*See Chapter 5  
for tips on getting  
the maximum  
benefit from a  
401(k).*

apples” plan comparisons. Don’t make the same mistake: look at the total package of employer contributions.

The first step is to compare the amount of the employer contributions. For example, an employer contribution equal to 5% of pay in a cash balance pension is generally better than a 3% employer matching contribution in a 401(k) plan. An employer contribution equal to 10% of pay in a profit-sharing plan is generally better than a 401(k) with an employer matching contribution. If an employer contributes 10% or more of pay to a retirement program, there is no need for comparisons—it’s a great place to work.

## Level of Employee Contributions

As of January 1, 2002, the maximum amount you can contribute to your 401(k) has increased to \$11,000. This limit will continue to increase over several years:

| Year       | Limit    |
|------------|----------|
| 2002 ..... | \$11,000 |
| 2003 ..... | 12,000   |
| 2004 ..... | 13,000   |
| 2005 ..... | 14,000   |
| 2006 ..... | 15,000   |

These limits apply only to your pre-tax contributions. Any employer contributions aren’t counted toward this limit.

Additional employee “catch up” contributions are permitted as of the same date for those who are age 50 or over:

| Year       | Limit   |
|------------|---------|
| 2002 ..... | \$1,000 |
| 2003 ..... | 2,000   |
| 2004 ..... | 3,000   |
| 2005 ..... | 4,000   |
| 2006 ..... | 5,000   |

Before this change in the law, the combined employee/employer contributions could not exceed 25% of pay. As a result, it was necessary for employers to limit the percentage of pay you could contribute. For example, you would have been limited to a maximum of 20% if your employer contributed 5%.

The combined employee/employer limit is now 100% of pay with a \$40,000 maximum, but your employer must modify the plan so you can contribute this higher percentage. In reality you can’t contribute 100%, even if there aren’t any employer contributions, because you must pay Social Security taxes and possibly state and local taxes. In addition you may have other pay deductions for medical coverage or contributions to a Section 125 flexible benefits plan.

If you could afford to do so, you could potentially contribute 80 to 90% of your pay. This opportunity will be a real plus for those who get started saving later in life, two income wage earners and those who start second careers after earning a military, police or other pension. For example, if you earn \$20,000 working part-time (after retiring from the military), you could contribute \$11,000 of this amount to a 401(k).

Push your employer to increase the percentage of pay you are permitted to contribute if they haven’t already done so. There isn’t any reason for your employer to limit the amount you can contribute, unless you are one of the highly paid employees. But, as you compare employers, remember that working for an employer that makes generous contributions for you is a lot better than an employer who contributes nothing.

## Vesting

The fact is that employees will eventually leave their employer and it may be sooner than they expect. Vesting is an important retirement plan issue: if employees are not vested, they will not take their employer contribution with them

when they leave. Employer contributions that are deposited into plan accounts don't really belong to employees until one of the following standard conditions gives them ownership rights.

1. Disability—as defined in the plan
2. Attaining normal retirement age, which is usually age 65
3. Death
4. Termination of the plan, or
5. Completing a specific number of years of service.

Once you achieve full vesting, all employer contributions belong to you, regardless of why or when you leave. Of course, if you change jobs, you're not immediately vested in your new employer's plan. This point should be fully factored into any employee's job search once full vesting is achieved in a plan that includes substantial employer contributions.

The maximum number of years of service that may be required before fully vesting matching contributions are legally defined. The two permissible methods are cliff and graduated vesting. With cliff vesting, ownership of the employer contribution goes from zero to 100% as soon as three years of service are completed. Graduated vesting occurs in 20% increments, reaching 100% after six years.

The following is a comparison of the two vesting schedules:

| YEARS OF SERVICE  | CLIFF | GRADUATED |
|-------------------|-------|-----------|
| Less than 2       | 0%    | 0%        |
| 2 but less than 3 | 0%    | 20%       |
| 3 but less than 4 | 100%  | 40%       |
| 4 but less than 5 | 100%  | 60%       |
| 5 but less than 6 | 100%  | 80%       |
| 6 or more         | 100%  | 100%      |

An employer may select an alternative that is equal to or better than these schedules. The two most common vesting alternatives for the 401(k)

plan are cliff vesting of 100% after three years or graduated vesting of 20% per year for five years.

## Eligibility

How long you have to work at a company before you are permitted to join the plan is an issue only when you are changing jobs—but it's a very important one. Until recently it was common to make newly hired employees wait one year before they could join a 401(k) plan. Actual entry into the plan was also commonly tied to quarterly entry dates—typically January 1, April 1, July 1 and October 1.

This delayed plan participation significantly: a new employee hired on January 12, 2001 would not have been able to start contributing to the plan until April 1, 2002, the first entry date after completing one year of service. If you change jobs more than five times, and you have to wait to join each plan for one year (and you wait even more time for entry dates), it could cost you up to 8 years without retirement benefits. A gap of this magnitude can have serious savings consequences.

Plan eligibility periods have been shrinking, however. Newly hired employees are now commonly eligible to join the plan within 90 days or less. Quarterly entry dates are being replaced by immediate or monthly entry.

## Access to 401(k) Money

Loans and in-service withdrawals are a mixed blessing because an employee's ultimate goal is to achieve an adequate level of retirement income. But having some access to savings can be an important plan feature, particularly for younger employees who have a long way to go to retirement.

Employees often say, "Why can't I do what I want with my money?" The answer is that employees are given various tax breaks to encourage them to save for retirement. These tax breaks come with a price: restricted access to savings for non-retirement purposes. These

restrictions apply during active employment with the employer that holds the retirement account.

There are three situations when money can be accessed from a plan account during active employment. Although each of these alternatives are legal, the employer is not required to make these plan features available.

The first alternative is to allow unrestricted access to plan assets after employees reach age 59-1/2. The withdrawn amount then becomes taxable, however. Next is the option to allow withdrawals for financial hardships (as defined by law and IRS regulations). Hardship withdrawals are also fully taxable and an additional early withdrawal tax penalty is imposed. The third possibility is to allow plan loans, which are also subject to numerous restrictions.

*See Chapter 9 for a detailed explanation of loans and hardship withdrawals.*

In service withdrawal and loan provisions should only be considered attractive plan features if employees are likely to need access to their money before they reach age 59-1/2.

## **Investments**

The big issue is the quality and the range of a plan's investment options. Ideally, the investments should include at least one fund from each of the major asset classes. It's impossible for employers to pick consistently top-performing fund options in each category. And funds that can boast top performance records may not even be the best choices. But there is no question that employees don't want to be stuck in funds that are at or close to the bottom of their respective categories year after year.

Timely access to investment information is another big issue. It's hard to manage a retirement account in the best of circumstances, but it's

almost impossible when important information is unavailable. Frustrated participants often tell me that they're unable to get performance information from both their employers and their service providers.

It's critical that appropriate standards are used to evaluate the quality of the investments in a plan. This comment may seem blatantly obvious, but it still needs to be said. The first step in performance evaluation is to compare a fund's total investment return over a period of time against similar funds.

You can't expect bond or other fixed-income funds to perform like stocks and vice versa. You also can't expect a value-oriented stock fund to perform like an aggressive growth fund. A value-oriented stock fund manager looks for bargain stocks. These may be specific companies or industries that are out of favor among major investors and stock analysts.

On the other hand, an aggressive growth fund manager typically looks for companies that are expected to have above average growth due to innovative products or new technology (Internet companies are a recent example). First understand what type of funds are in the plan, then make accurate comparisons.

*Chapter 8 helps you understand and evaluate the different types of funds.*

## **Expenses**

Plan expenses are another key factor for comparison. There are four common types of expenses—administrative, investment, transaction-related and wrap fees.

One of the major administrative services involves keeping track of the money you have in your plan account and generating periodic statements. These records are maintained on computer systems that are designed to handle retirement plans like the 401(k). This recordkeeping func-

tion can be provided by a single person working on a PC in a home office or a massive financial organization. The employer selects an organization to provide the function or decides to handle it internally. There aren't any standards for this service, which accounts for the wide range of providers.

Other administrative services include determining benefits that are to be paid when employees terminate, issuing checks to participants, withholding and paying taxes, loan and hardship withdrawal processing and plan compliance testing.

The annual cost for administrative services, including the support to participants that is discussed below, are in the range of \$100 per participant annually. This is a fixed cost for all participants in a plan, regardless of account size. Administrative costs are also similar among providers because they all must hire people with similar skills, use similar computer systems, and so on. The factor that varies the most is who pays these fees.

Administrative expenses are usually paid by the employer in young plans because this is the only viable alternative. A new plan participant would be reluctant to pay a \$100 annual administrative fee. That fee would represent, for example, 5% of your annual contribution of \$2,000. If the investments you chose then dropped 10% in value, your account would then be worth only \$1,700 (after deducting the administrative fee and the investment loss). This significant drop in value might discourage you from further plan participation.

It's a common practice to shift payment of the administrative fees from the employer to the participant as the plan matures. After the assets grow, these fees constitute a relatively small percentage of your account balance.

Assume a plan that has 500 participants has accumulated \$25 million of assets—an average of \$50,000 per participant. The annual administrative fees are \$50,000 at \$100 per participant. This

total fee amount is equal to only 0.2% of the plan assets. This means that if participants cover these costs, their investment return will be reduced by only this small percentage.

Participants don't always realize that they're paying administrative fees. The fee may be clearly shown on the statement, or it may less visibly reduce the investment return participants receive. In the latter instance, participants simply see changes in the value of their shares net of all expenses. The fees that are deducted are totally hidden.

The second type of fee you pay is the investment fee—typically a percentage of the account balance. This percentage varies substantially depending on the type of available funds. Actively managed funds carry the cost of a manager who picks the stocks, and passive “index” funds that do not require human intervention are less expensive. The annual fee for an actively managed stock fund is in the 1.0% range, compared to 0.20% for an index fund. Actively managed stock funds are also more expensive to run than bond funds. Funds that invest solely in international stocks are more expensive to run than those that invest only in stocks of U.S. companies.

You can find the investment management fee for each registered mutual fund in the fund's prospectus. (Look on the fund company's web site, or call them directly for a copy.) Investment vehicles offered by some financial organizations are not required to provide a fund prospectus. As a result, it can be very difficult to get straight answers on fees for some funds.

I've heard representatives of financial organizations tell employees that they do not pay any fees. Don't believe this: no organization that runs a 401(k) plan does so for free. The question is how participants pay the fee—not whether they pay one. Participants don't actually write a check as payment for a fee, but the reduction in their investment return is a powerful form of payment.

The investment management fee that fund companies charge for retail mutual funds is much more than is needed to cover investment-related costs. For a 500-participant plan with \$25 million of assets, the typical fund company receives fees of \$200,000 to \$250,000—or \$400 to \$500 per participant. Typically, \$100 per participant covers administrative fees and the balance covers investment-related costs.

However, this method of covering administrative costs from investment fees creates inequities because not all participants share costs equally. A new participant may only have a \$2,000 plan balance at the end of the first year. How does this participant's \$100 administrative fee get paid? It's paid by participants who have larger account balances.

I recently spoke on a panel where this type of fee structure was debated. One panelist was a young representative of a major fund company. Another was an age 50+ individual from a consulting firm. The fund representative argued that it's justifiable for participants who have larger balances to subsidize the administrative costs for participants who have smaller balances. Her rationale was that "Someone did this for you at some point." But the older panelist did not agree.

Perspectives on this issue are likely to vary with each person's stage in life. Expecting new participants to pay a \$100 administrative fee isn't any more acceptable today than it was when I started the first plan years ago. But there should be a better alternative than saddling participants who have larger balances with this expense.

One alternative is to return to employer payment of the administrative fee for new participants. The primary reason this practice stopped is that there was no perceived value for this invisible benefit. Years ago I suggested that one of my larger corporate clients shift this expense to participants and use their savings for a visible benefit like an increased company match, and they took my advice.

How could employers make their payment of administrative fees for participants who have smaller balances more visible?

It could be included on the participant statement as an additional employer "contribution". Or for the first five years of participation, the employer could cover this expense for employees who are not in the highly compensated group. The added benefit could also help employers pass the non-discrimination tests. And paying the administrative fees for participants who have small balances would be a win-win situation—those who have small balances would continue to receive help and those with larger balances would no longer have to bear an inequitable cost.

It's ironic that employers pay all actuarial and administrative expenses for defined benefit pension plans, even though there is no perceived benefit value. Why is the perceived value of this fee payment such a big issue for 401(k) plans? I know some readers will think I don't realize your company pays these fees out of surplus DB plan assets. But what will your company do when excess pension assets dry up? It's not likely that these fees will be deducted from employee paychecks.

The third type of fee is tied to specific transactions, including loans, hardship withdrawals and benefit payments. The organization that handles the plan most likely deducts an additional fee from participant accounts for each of these transactions. For example, there may be a fee to take out a loan and an annual administrative fee during the period of repayment. Participants commonly pay these fees because they trigger the transaction—it's similar to an ATM fee.

The fourth and last fee is a wrap fee, which is an additional asset-related fee that may be charged for a variety of reasons. Small employers that have less than 100 participants are most often charged this fee. The fee is likely to range between .5% and 1.5%, and it is in addition to the normal fund management fee.

For example, a plan may offer a variety of name brand funds from different fund families. Participants pay the standard fund management fee, which is probably between .7% and 1.5% of their assets annually. The organization that sells and services the 401(k) receives an additional .5% to 1.5% of participant assets. This combination of asset-based fees pushes the cost of investing into the 1.2% to 3.0% range per year.

Wrap fees reduce the participant's investment return even more. Assume one of the fund options is the Fidelity Magellan Fund and the organization that runs the plan charges an extra wrap fee of 1.5%. Each year the participant's investment return will be exactly 1.5% less than the return reported by Fidelity. A 1.5% additional wrap fee reduces 30-year savings by 30%!

It's often difficult to get the full story on fees. I've been pushing for greater fee disclosure because it's tough to make informed investment decisions when the firm that handles the 401(k) plan refuses to disclose their fees.

I was one of many who appeared before the DOL when it conducted hearings on fees a number of years ago. Representatives from several financial organizations that are not willing to disclose fees claimed it is too expensive to do so. They also believe that fee information only confuses participants. (Amazingly, Vanguard and TIAA/CREF are the two lowest cost defined contribution service providers and they both fully disclose their fees.)

This provider attitude does not make sense. Imagine buying a car and authorizing the dealer to deduct the monthly payment from your checking account without knowing the cost. In my opinion, fee information should be included on the participant statement, rather than buried in the fund prospectus. I want participants to know which fees they're paying to whom—and be able to evaluate the services they are receiving versus the costs. Some extra fees may be worthwhile in exchange for valuable services.

If administrative and investment fees are distinguished, it will also be easier for participants to evaluate investment alternatives. When the plan administrative fees have been paid directly by the employer or the participant—rather than buried in the investment management fee—participants can consider less expensive investment alternatives such as index or institutionally priced funds. Even if participants are not paying the administrative fee up front, they usually pay it in the end—so it makes sense to consider more cost-effective options.

Institutionally priced funds are geared to large investors like pension funds or endowment funds of colleges and universities. Employers are increasingly selecting the same investment managers for the 401(k)—but because of the volume of money invested, they pay less. It doesn't cost an investment manager 10 times more to invest \$100 million than \$10 million. As a result, investment management fees usually drop as more money is invested.

The nation's 401(k) participants are collectively investing \$2 trillion. This huge amount of money should give participants access to less expensive investment alternatives than retail mutual funds. The barrier to this is the practice of bundling administrative and investment services and paying for both types of services from asset-based fees. Unbundling the payment for these two different types of services allows participants to explore investment alternatives more intelligently.

A move toward lower-cost investment alternatives began a few years ago, and it will continue. Previously, when there was strong stock market performance throughout the 90s, participants were indifferent to fees. It was hard to get worked up over this issue when net investment returns were 15% or higher. The fact that a participant may have been able to earn another .5% to 1% with lower investment fees wasn't really a big deal. Investment fees become a much bigger deal

when investment returns aren't as robust and may even be negative. Few would argue that a 9.5% return is a lot more attractive than 8.0%.

Participants can do little to change the minds of providers who will not provide fee information. On their behalf, I have asked the DOL to modify the Section 404(c) regulations to require full fee disclosure for plans that want to be compliant. I have also suggested a warning label be put on a provider's sales literature and participant information if they don't disclose fees and their product is not Section 404(c) compliant. That suggestion has received a few chuckles, but I do think that it would motivate more providers to disclose fees.

Another controversial issue concerns employer rebates. In some instances when large employers are investing many millions into name brand retail funds, the employer actually receives money from the fund company to help cover internal plan costs or other plan services such as education. This rebate may also be used to cover administrative costs for participants who have selected less expensive investment options. In large company plans participant contributions generate the rebates—so I believe that these fund credits should go back into their accounts. As participants continue to focus on fee issues, employers will be pressured to rethink the rebate situation.

## **Participant Support**

The larger organizations that manage 401(k) plans offer a lot of support. Participants can call an 800 number or log on to the Internet to get detailed information about their plan investments at any time. This should include fee information and historical investment results. Participants should also be able to make changes at any time—move money from one investment to another, change their contribution rates, etc.

The provider should also offer a lot of educational support for retirement planning. At a minimum this support should include:

- A retirement calculator to help participants determine how much they will need when they retire and how they should invest to reach their goals
- Account statements and other tools to help participants measure their progress toward a specific goal
- Information about the various types of mutual funds to help participants understand their investments
- Investment support to help participants formulate the most appropriate asset allocation
- On-site educational seminars.

What can participants do when their plans aren't competitive? Many participants and journalists ask me this question. The answer depends on the reason the plan is not competitive. It's a disadvantage, for example, if a plan does not have any employer contributions, but there probably isn't much that participants can do except save more. In the case of small employers, many simply can't afford to contribute.

When a plan lacks other important features, participants are best advised to gather competitive information about other employer plans. Local information can be obtained from the Chamber of Commerce. National information can be obtained from the profit-sharing/401(k) Council ([www.PSCA.org](http://www.PSCA.org) or 312-441-8559).

Sometimes the information participants gather can clear up employer misconceptions. A lot of small employers overestimate the cost of a matching contribution. A 25% match limited to the first 4 to 6% of eligible pay costs less than 1% of pay, because not all eligible employees will contribute and some will contribute less than the maximum amount that is matched.

For example, matching the first 4% of pay that is contributed at the rate of \$.25 per \$1.00 will cost only .75% of pay if 75% of the employees contribute at least 4% of pay. The annual total will be only \$750 per \$100,000 of eligible payroll.

This is not an insurmountable amount for even a small employer—and it's very probable that the cost would be recovered through reduced employee turnover.

Employers often need to be reminded that the 401(k) not only helps to retain employees, it helps to attract them as well. Information about competitive plans can help employers shape a plan that draws more top employees to their companies.

The most common area of employee dissatisfaction is not contributions, however. Performance and a lack of available information are the two most common complaints, closely followed by the number and type of funds offered.

On the information front, employees are often shocked to discover that employers are required to provide only three things:

- A Summary Plan Description (SPD)
- A Summary Annual Report (SAR), and
- An annual statement of each employee's account.

The SPD explains the general terms of the plan—who is eligible and when, the types of contributions, vesting, etc. The information about plan investments is typically limited to a generic fund description. In some cases an SPD doesn't give fund descriptions and says only that participants are able to split their contributions among various funds selected by the employer.

Distributed annually to each participant, the SAR contains information that is taken from the Form 5500 that is filed with the government. This form is due by the July 31st following the close of the calendar plan year.

The SAR contains general information about the total plan assets for the plan year that ended on the December 31st preceding the filing date. This means the information is very dated by the time you receive it. For example, the 5500 Form filed by July 31, 2002 contains the information from the plan year ended December 31, 2001.

In the SAR you'll find general financial results for the year for the entire plan. It includes the total contributions, interest, dividends, realized and unrealized gains, benefit distributions, etc. for the entire plan. None of this information helps you decide how to invest your money.

The annual benefit statement doesn't have to include detailed information on the actual return and expenses for each participant's investments. The statement may be limited to the beginning balance, contributions, withdrawals, investment gains or losses and ending balance. A growing number of service providers are reporting a lot more information, including each participant's specific rate of return. These voluntary efforts are to be applauded.

Participants often receive a lot of other services and information that employers are not required to provide. These include quarterly statements, the opportunity to call a toll-free 800 number to ask investment and other plan account questions and Internet access to plan information.

It's also important to point out that educational support from employers or service providers is not legally required. I know some readers will say "but what about Section 404(c)?" (Sorry, I promised earlier that this book wouldn't be filled with IRC Code Sections, but this is one of those times when it can't be helped.)

Years ago the Department of Labor issued regulations to provide some fiduciary relief to employers. These regulations are known as Section 404(c). If employers want the fiduciary relief, they have to structure their plan investments in accordance with these regulations. One requirement is that participants must be given sufficient information to make informed investment decisions. But, these regulations are voluntary rather than mandatory. The regulations also do not contain any further guidance about what is adequate information to make informed investment decisions.

Even though participants may get a lot more information than what is legally required, it is probably not enough. What can participants do? They should ask their employers and/or service providers for the information they need. I recommend submitting written requests.

Here's a sample letter:

*Dear 401(k) Plan Representative:*

*Planning for my retirement is a serious matter. I want to do everything I can to be sure that I have an adequate income during my retirement years. I understand this is my responsibility, including how to invest the money I contribute to my 401(k) plan.*

*Unfortunately, I haven't been able to make informed investment decisions because I can't get adequate information about the fees that I pay. I've called the service center at the Outback Investment Company and their representative told me I don't pay any fees. Perhaps I should consider this wonderful news, but I'm not dumb enough to believe that it's true.*

*As a result, I'm requesting a written explanation of all the fees that I pay, including those that are deducted from plan assets by the organizations that invest and manage the plan—and reduce the net investment return I receive.*

*Sincerely,*

*Participant*

A letter to a service provider is one way to get to the bottom of the fee issue, but it's not a guarantee that you will get a detailed response. Another way you can find hidden fees is to compare the annual fund returns reported on your statement with those that are publicly reported for the same funds.

Assume Caroline has money invested in the Janus fund through a 401(k) plan. When she looks at the fund's annual return on her statement, she sees that it's roughly 1% less than the published return for this fund. This is a good indication that

she is being charged an additional 1% plus the normal investment management fee Janus charges.

Several years ago I received a call from the president of a company who asked if I would review his company's 401(k) plan. He explained that some of the participants were unhappy with the plan's investments—even though a consultant he hired concluded that they had nothing to complain about. When I read the investment advisor's report, I was surprised that she didn't mention the fact that participants were being charged an extra 1.0% annual wrap fee on their contributions and another 1.5% fee on the employer contributions. As a result, the total fees being charged to participants were in the 2.0% to 2.5% range.

The unhappy participants had suspected they were paying additional fees, but they didn't have any proof because they were buried. The president was motivated to change this situation because some employees had stopped contributing to the plan. This reduced the amount he could contribute and the payment of the additional fees also reduced his own annual returns. Because the participants were not receiving any additional services for the fees that they were paying, they had nothing to lose if the plan was moved to a lower-cost provider. And that is what actually happened.

As you've read in this section, there are not a lot of ways that participants can influence plan sponsors to change their plans. The situation above, however, is an example of participant power. Most employers offer a 401(k) plan to help attract and retain good employees. Senior management wants employees to be happy with the plan so that they'll join the company, stay on and be productive. Realistically, they also want a good plan with low fees for personal reasons. When participants stop contributing, it impacts senior management pocketbooks and it can bring about change.

I caution participants that this action will not *always* bring about change. And missing out on

employer and employee contributions can be a high price to pay for change. Participants need to be sure that their dissatisfaction with fees is justified before they take any action.

One example is a participant who called to tell me that he was really unhappy with the service provider for his plan. He had just received his statement, which showed a negative return for the bond fund. I knew that the organization that handles his plan is a quality provider, so I dug deeper.

He told me that outside of the 401(k) he buys bonds that produce a 6%+ return. He said that he never has any losses because he gets his money back when the bonds mature. I then explained that with a 401(k) it's necessary to report the value as if the bonds were being sold as of the statement date. As a result, the return that appears on his statement reflects both income and changes in value for each bond held. This explanation calmed him down and helped him realize that complaining to his employer would not have been justified.

Participants have a better chance of getting their company plan sponsors to listen and take action if they submit detailed written complaints. Generic complaints (either verbal or written) that simply state that a plan's investment options stink are not very useful. It's best to explain why, specifically, there is dissatisfaction. It may be the fact that a particular type of fund is not offered—or it may be due to excessive fees or poor performance.

Here's a sample letter that may get the attention of a plan sponsor:

*Dear Plan Representative:*

*I take 401(k) investing very seriously because I want to do everything I can to be sure I have an adequate income when I retire. As you know, investment return has a major impact on the savings that I and other participants will accumulate.*

*I am very dissatisfied with the return of our large-cap stock fund, the Outback Super Stock Fund. In the past year the return for this fund was 2.4% less than the S&P 500 index. During the last three years the fund returned an average of 2.6% less than the S&P. This fund has also ranked in the bottom quartile for three years, and it has only a two-star Morningstar rating.*

*It would clearly be in the best interest of all participants to replace this fund with a similar fund that has a better track record and rating.*

*Sincerely,*

*Participant*

This letter contains specific reasons for the dissatisfaction supported by Morningstar ratings, an independent source. It also properly identifies the type of fund and compares its performance with the S&P index—an appropriate benchmark for this type of fund. Gathering all this information may appear to be very difficult, but it isn't. *Morningstar.com* (or other similar fund resources) provides all this information.

Participants need to consider the culture of their employers before they start attacking the 401(k), however. They don't want to be labeled as troublemakers if this is how their employers view people who complain.

When participants fail to get the information they need, I encourage them to write to the DOL. Letters should be addressed to the Assistant Secretary of Labor, Pension and Welfare Plans Administration, 200 Constitution Avenue, N.W., Washington, DC 20210. Ann Combs is the Assistant Secretary at the time I am writing this book. Participants should explain what efforts they have made to get the information they need and the responses they received.

In the end, as participants evaluate their 401(k) plans, they are really evaluating the corporate citizenship of their employers. How an employer shapes a 401(k) often reflects how they view and treat their employees. 401(k) atti-

tudes and actions vary widely among companies, and participants need to decide if they're investing their time and retirement savings potential in the right company over the long term.

Some companies simply do not put a lot of emphasis on helping their employees save for retirement. The benefit manager of a company that owned a national chain of restaurants told me about a new board member who was troubled by the fact that less than 50% of the eligible employees contributed to the 401(k)—even though there was a 50% employer match. The benefit manager was asked to develop an educational campaign to increase participation.

The benefit manager presented his proposed campaign to the company's board but they voted it down. Why? Because the board soon realized that a 10% increase in the participation rate would have cost the company \$1 million per year.

In contrast, the attitude at CYRO Industries is far more benevolent. Bill Dorcas, CYRO's benefit manager, has a passion for helping employees save for retirement through a comprehensive program of "Choice & Responsibility". CYRO's 401(k) plan objectives are to:

- Aid in affecting good behavior and practices for retirement savings and planning.
- Use investment education and retirement planning to help employees meet their Choice & Responsibility for a successful retirement.
- Give all employees a flexible, convenient way to save for retirement while saving on current taxes.

CYRO goes much further than most companies to help employees understand the impor-

tance of using the 401(k). Here are just a few examples of how CYRO goes the extra mile for employees:

- Mandatory meetings for all employees not enrolled in the plan
- Mandatory investment education and retirement planning meetings for all employees
- 401(k) articles in the company newsletter
- One-on-one employee meetings that include retirement modeling software
- An investment education library
- Annual personal letters to all non-participants
- Personal meetings with all non-participants to discuss the reason why and provide potential 401(k) savings projections
- Requirement that all non-participants sign a waiver acknowledging the potential loss of 401(k) benefits
- Reminders to employees to increase 401(k) contributions when they receive pay increases.

The examples on the next two pages illustrate several ways you can increase your plan participation.

Why does Bill have such a passion about what he does? He says, "One of my personal goals in life is to truly make a difference in the lives of others. By helping our employees save more, invest wisely and strive for financial security in their retirement years, I'm meeting that personal goal." My personal thanks and congratulations to Bill Dorcas and others like him who are truly dedicated to helping employees save for retirement.

## YOUR PERSONALIZED RETIREMENT PLAN SAVINGS SUMMARY

### SAVING JUST \$43 PER PAY PERIOD CAN GET YOU HEADED DOWN THE ROAD TO A MORE COMFORTABLE RETIREMENT!!!

October 23, 1997

EILEEN

**Will you be ready to retire when the time finally rolls around?** The CYRO Industries 401(k) Employees Savings Plan can make it possible. This summary illustrates your potential "nest egg" at retirement if you were to enroll in the CYRO Plan today. It is based on the following assumptions:

- You are contributing 4% bi-weekly of your current salary of \$28,028.
- A 15% Federal marginal tax bracket.
- Company Match contributions based on the following:  
\$0.75 for \$1.00 on the first 4% of your contribution
- Investment returns are calculated assuming your entire portfolio averages a rate of return of 8%. (Please note that this is not a representation of the options in your particular plan.)
- An annual salary increase of 4%.
- You will retire at age 65.

| YEARS<br>OF<br>PARTICIPATION | YOUR<br>"OUT OF POCKET"<br>COST* | ACTUAL<br>CONTRIBUTIONS | COMPANY<br>MATCH | TOTAL ACCOUNT<br>BALANCE |
|------------------------------|----------------------------------|-------------------------|------------------|--------------------------|
| 5                            | \$5,161                          | \$6,072                 | \$4,554          | \$12,864                 |
| 10                           | \$11,441                         | \$13,460                | \$13,460         | \$34,552                 |
| 20                           | \$28,377                         | \$33,385                | \$25,275         | \$125,740                |
| 30                           | \$53,446                         | \$62,878                | \$47,158         | \$347,171                |

*Your out of pocket cost represents your actual cost of investing money in your pre-tax account. Your actual contributions represent the amount of pre-tax contributions in your account. Projections shown above do not reflect any unusual tax situations such as excise taxes, penalty taxes, or the alternative minimum tax.*

If you join the CYRO Plan today, you could have \$347,171 at retirement (in 30 years), if all of the above assumptions are met. That translates to \$2,193 a month in the form of an annuity to supplement any other retirement income you may have. This monthly payout is determined by assuming you enjoy 25 years of retirement earning a 6% pre-tax rate of return on your money once you retire. Of course, the actual results you may realize will vary depending upon your salary increases, investment results, and other factors. So don't get lost on the road to retirement .... **enroll in the CYRO Industries 401(k) Employees Savings Plan today!**



## CYRO INDUSTRIES 401 (k) EMPLOYEES SAVINGS PLAN

### ACKNOWLEDGEMENT OF PLAN EDUCATION AND WAIVER OF BENEFIT

I ALSO CONFIRM THE UNDERSTANDING THAT THIS DECISION RESULTS IN THE LOSS OF THE COMPANY MATCH MONEY WHICH IS EQUAL TO AN AMOUNT OF UP TO 3% OF MY CYRO EARNINGS, ALONG WITH LOSS OF POSSIBLE PERFORMANCE MATCH OF UP TO AN ADDITIONAL 1% OF MY CYRO EARNINGS. I FURTHER AGREE THAT I UNDERSTAND THE VALUE OF COMPOUNDING.

I ACKNOWLEDGE THAT CYRO HAS INFORMED AND EDUCATED ME ABOUT THE BENEFITS OF PARTICIPATING IN THE PLAN. AT THIS TIME I DECLINE TO PARTICIPATE.

SIGNED \_\_\_\_\_

NAME PRINTED \_\_\_\_\_

DATED \_\_\_\_\_

### **Tips on Recognizing a Good 401(k) Plan**

- When you compare 401(k) plans, first look at the amount of employer contributions.
- Compare all employer contributions—not just the 401(k) match.
- Remember that an employer that contributes 10 to 15% of pay to a retirement plan without requiring participant contributions is a better deal than a 401(k). (Even a 401(k) that has a healthy employer matching contribution.)
- Compare apples to apples when you compare plan investments.
- Don't believe that any 401(k) provider does not charge fees.
- Review fees carefully: the expenses you pay directly impact your investment returns and the savings you accumulate.
- Submit written comments about plan dissatisfaction to company plan sponsors and 401(k) providers. Be specific and substantiate your points.



