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Do IRAs Really Cost More Than 401(k) Plans?

Providing retirement savers with information that is significantly more transparent would help them determine the actual costs of participating in both IRAs and 401(k) plans.

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Be careful what you wish for, you just might get it. No one is certain about the origins of this admonition, but we are all familiar with the idea of unintended consequences. Sometimes, the steps we take to address one issue lead to a new set of issues we had not anticipated.

Consider automatic enrollment, which many agree has done more to improve retirement security than any innovation during the past three decades. [Rebecca Moore, "SURVEY SAYS: Least/Most Effective Retirement Industry Developments in the Last 25 Years," PlanSponsor, *https://www.plansponsor.com/survey-says-least-effective-retirement-industry-developments-last-25-years*" (2018)] This innovation has helped plan sponsors overcome participant inertia and has dramatically improved participation rates in plans that have adopted it. There was a downside, though.

It seems the unexpected consequences of automatic enrollment include an increase in the number and aggregate value of small plan accounts, as well as greater regulatory scrutiny around issues associated with accounts that participants have left behind.

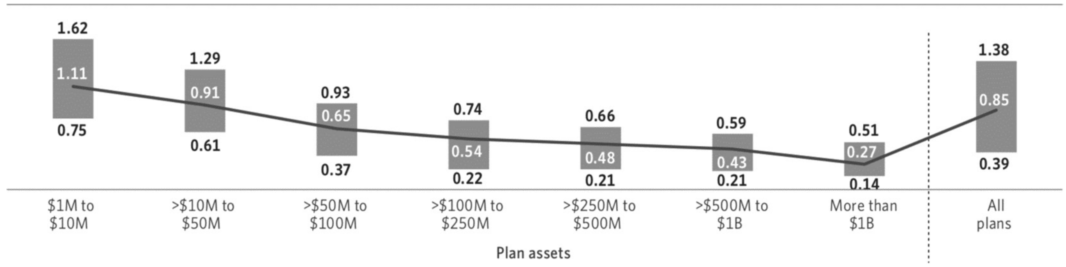
Another example of unintended consequences resulted from communications surrounding the Department of Labor's (DOL) Fiduciary Rule regarding individual retirement accounts (IRAs). In 2015, the Executive Office of the President of the United States published *The Effects of Conflicted Investment Advice*. The report shared the findings of the Council of Economic Advisors and stated:

> Moreover, investment fees in a typical IRA may exceed investment fees in a typical 401(k) according to a series of recent GAO reports (GAO 2009, 2011, 2013). While

Figure 1

Distribution of Total Plan Cost by 401(k) Plan Assets

10th percentile, median, and 90th percentile plan-weighted total plan cost as a percentage of assets among plans with audited 401(k) filings in the BrightScope database by plan assets, 2015*



* *Total plan cost* is BrightScope's measure of the total cost of operating the 401(k) plan and includes asset-based investment management fees, asset-based administrative and advice fees, and other fees (including insurance charges) from the Form 5500 and audited financial statements of ERISA-covered 401(k) plans. Total plan cost is computed only for plans with sufficiently complete information.

Note: The sample is 18,853 plans with $3.2 trillion in assets. BrightScope audited 401(k) filings generally include plans with 100 participants or more. Plans with fewer than four investment options, more than 100 investment options, or less than $1 million in plan assets are excluded from BrightScope audited 401(k) filings for this analysis.

Sources: BrightScope Defined Contribution Plan Database and Lipper

> rolling over balances to an IRA makes financial sense for many people, when doing so incurs meaningfully higher fees, it generally does not.

[“The Effects of Conflicted Investment Advice on Retirement Savings,” p.8 The Executive Office of the President of the United States, *https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf,* (Feb. 2015)]

Since the report was released, general understanding in the marketplace has been that IRAs are more expensive than 401(k) plans. Consequently, many people have come to accept that plan participants:

- Pay modest fees to invest through workplace plans
- Pay higher fees when they roll over retirement savings into IRAs, and
- If possible, would be better off transferring their savings into new employers' plans.

And yet, this is not always the case.

How Much Do 401(k) Plan Participants Pay?

From 2006 through late 2016, numerous lawsuits were filed accusing defined contribution plan sponsors and plan service providers of charging excessive or hidden fees. Most 401(k) plan sponsors hire service providers to help with administrative, participant-focused, regulatory and compliance services, and investment management, because running a retirement plan is not their core business. The service providers they hire charge fees.

Generally, litigation has focused on plan sponsors' ability to determine actual plan and participant costs and prove that their plan costs were reasonable and equitable. In many cases, revenue sharing was the issue. Revenue sharing is the practice of paying for plan services through a plan's investment options by making the cost of services a part of investment expenses. [Greg Carpenter, “Revenue sharing is on the decline in 401(k) plans. Three reasons it will be gone soon,” Employee Fiduciary, *https://www.employeefiduciary.com/blog/revenue-sharing-is-on-the-decline-in-401k-plans”* (2014)]

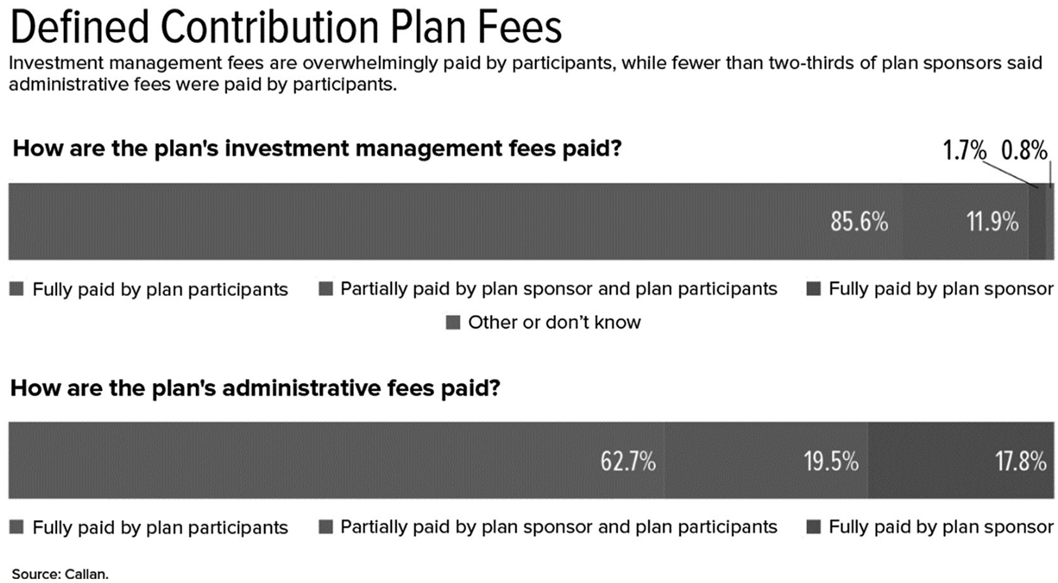
Revenue sharing makes it difficult to determine the actual cost of plan services, because money collected and paid to service providers reduces investment returns. As investment fund returns generally are reported net of fees, the cost of plan services is not explicitly stated.

After a decade of litigation, plan sponsors and other plan providers have become painfully aware of the importance of being able to clearly articulate plan and participant expenses and of using benchmarks to demonstrate that the fees being paid are reasonable for the services provided.

Plan costs have come down in recent years, and revenue sharing is less prevalent than it once was. Regardless, the range of 401(k) plan costs is wide. Typically, costs for larger plans are lower than costs for smaller plans.

A March 2018 analysis of plan data gathered from 2015 audited Form 5500s for plans with $1 million or more in assets found “significant diversity in total plan cost,” with costs decreasing as plan size increased. [BrightScope and Investment Company Institute,

Figure 2



Source: Stephen Miller, "401k Sponsors Focus on Benchmarking–and Lowering–Fees," Society for Human Resource Management, *https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/401k-fee-benchmarking.aspx* (Feb. 2018)

"The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2015," *www.ici.org/pdf/ppr_18_dcplan_profile_401k* (Mar. 2018)]

Overall cost for the largest plans surveyed (more than $1 billion in assets) ranged from 0.14 percent of assets to 0.51 percent. In contrast, four-fifths of plans with $1 million to $10 million in assets had total costs ranging from 0.75 percent to 1.6 percent of assets. Smaller plans' costs tend to be higher. The latest *401k Averages Book* estimated plans with $1 million in assets and 100 participants would have total costs of 0.72 percent to 2.80 percent of assets. ["18th Edition 401(k) Averages Book," *https://www.prnewswire.com/news-releases/401k-averages-book-update-includes-fees-for-plans-with-100000-average-account-balances-300601152.html* (Feb. 2018)]

In most plans, investment management fees are paid entirely by participants, and, in about two-thirds of plans, administrative fees also are the responsibility of participants. [Callan, "2018 Defined Contribution Trends Survey," *https://www.callan.com/wp-content/uploads/2018/01/Callan-2018-DC-Survey.pdf* (Jan. 2018)]

Generally, plan fees are determined by the size of the plan and the services available to participants. Yet, there is so much variation from one plan to the next.

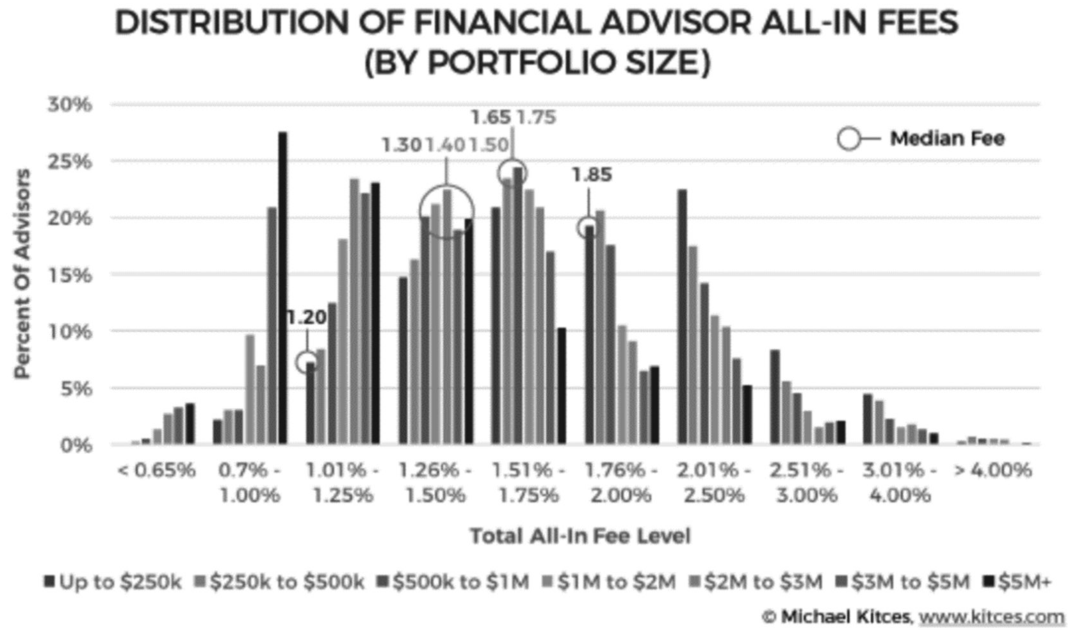
How Much Do IRA Accountholders Pay?

IRAs have long played a vital role in the retirement system by helping plan participants preserve savings accumulated for retirement. A recent white paper prepared for the DOL by the Center for Retirement Research at Boston College estimated that, "As of 2016, more than half of 401(k) balances had been rolled over to IRAs .... As a result, IRAs are now the largest single repository of retirement plan savings." [Dr. Alicia Munnell, Anek Belbase, Dr. Geoffrey Sanzenbaher, "An Analysis of Retirement Models to Improve Portability and Coverage Page 12," Center for Retirement Research at Boston College and Summit Consulting, *https://www.dol.gov/asp/evaluation/ completed-studies/An-Analysis-of-Retirement-Models-to-Improve-Portability-and-Coverage.pdf* (Feb. 2018)]

When plan participants roll over savings into IRAs, they may choose self-directed IRAs, robo-advised IRAs, broker-dealer advised IRAs, or Registered Investment Advisor (RIA) advised IRAs. And, of course, pricing structures vary significantly from provider to provider. For instance,

- An IRA offered by a robo-advisor had a single investment option and charged a management fee of 0.25 percent for accounts with balances of less than $100,000. It charged no fees for transferring assets into or out of the account.
- A self-directed IRA provider offered diverse investment options and charged a management fee of 0.35 percent, as well as a per-trade charge and a fee of $50 when the account is closed.
- Advised IRAs offer diverse investment options and may charge financial planning, investment

Figure 3



Source: Michael Kitces, "Financial Advisor Fees Comparison–All-In Costs for the Typical Financial Advisor," *https://www.kitces.com/blog/ independent -financial-advisor-fees-comparison-typical-aum-wealth-management-fee,* (July 2017)

management, and/or platform fees, in addition to investment product expenses. [Michael Kitces, "Financial Advisor Fees Comparison–All-In Costs for the Typical Financial Advisor," *https://www.kitces.com/blog/ independent -financial-advisor-fees-comparison-typical-aum-wealth-management-fee,* (July 2017)] The median fee varies by account size, according to Michael Kitces. While these fees are higher than other IRA options, the services offered may help to improve financial outcomes.

Generally, the cost of an IRA is determined by the size of the account and the services provided. While some people may be well-versed in financial matters and prefer to select and manage investments themselves, others may prefer the help of a financial advisor or a robo-advisor.

Broad Generalizations Don't Prove Out

As with many things retirement plan related, there is no single, clear answer about 401(k) costs relative to IRA costs. Some IRAs are more expensive than 401(k) plans. Some 401(k) plans are more expensive than IRAs. Each participant's experience will depend on a variety of factors, including the amount of savings, the size of the 401(k) plan, and the type of IRA.

Regardless, some in the industry have come to accept the idea that IRAs are an expensive option that diminishes rather than preserves participants' retirement savings. Some policy experts have suggested that participants would be better off transferring their savings from one employer's plan to another, even though the Government Accountability Office (GAO) has acknowledged the challenges involved:

> For example, when seeking to initiate a plan-to-plan rollover, participants may face waiting periods to roll a DC account balance from a previous employer into their new employer's plan, complex verification procedures to ensure that savings are tax-qualified, wide divergence in plans' paperwork, and inefficient practices for processing such rollovers.

[U.S. Government Accountability Office, "The Nation's Retirement System: A Comprehensive Re-evaluation Is Needed to Better Promote Future Retirement Security" p. 44, *https://www.gao.gov/assets/690/687797.*pdf (Oct. 2017)]

A recent paper prepared for the DOL suggested a variety of ways to improve retirement security. Some had merit, such as enhancing portability by standardizing rollover rules and paperwork. Others, including a variety of employer mandates, seem antithetical to free markets. The paper also suggested:

> A clearinghouse that would automatically roll over balances from one plan to another could address many of the portability issues. One such proposal—at least for small balances—has been suggested … to establish a platform to automatically route all the participant's old 401(k) balances to their next 401(k) plan through an IRA. The suggested costs are $1.50 to $3 per month in custodial fees for the holding period and a $49 fee for the electronic transfer to a new plan. The goal is to keep the small balances in an IRA for as short a period as possible before transferring them to a new plan.

{Dr. Alicia Munnell, Anek Bel base, Dr. Geoffrey Sanzenbaher, "An Analysis of Retirement Models to Improve Portability and Coverage Page 12," Center for Retirement Research at Boston College and Summit Consulting, *https://www.dol.gov/asp/evaluation/ completed-studies/An-Analysis-of-Retirement-Models-to-Improve-Portability-and-Coverage.pdf* (Feb. 2018)}

While a clearinghouse for retirement accounts is interesting, it could come with host of unintended consequences. For example, what happens if:

- A participant's retirement account information is not up-to-date?
- The new employer does not offer retirement benefits?
- The new employer's plan costs are higher than those of the former employer's plan?
- The new employer's plan costs are higher than those of a rollover IRA?
- The new employer's plan is not compatible with the former employer's plan?
- The participant remains unemployed for a significant period of time?

While improving portability is important, the clearinghouse described above has the potential to add layers of complexity to a system that needs more simplicity. To improve portability, let's try to keep it simple and create a process that reduces paperwork and time.

It would be nice if decisions could be based on perfect information. Certainly, that is not the case when thinking about the value of—or more specifically, the costs of—retirement plans or IRAs. It would be nice if comparable information were readily available to retirement savers. At the moment, transparency is encouraged and required, but it is not always provided. Unfortunately, in fact, it is rare. ■