Why Your 401(k) Could Be Quietly Costing You Thousands — And What You Can Do About It

BY ROBERT BROKAMP, CFP®
ADVISOR, *MOTLEY FOOL RULE YOUR RETIREMENT*

A SPECIAL REPORT BROUGHT TO YOU BY
Motley Fool™ Wealth Management

Dear Fellow Fool,

If you're like the vast majority of Americans, you haven't worked for the same employer your entire life.

And while you might not have realized it, this simple fact may give you the ability to optimize a good portion of your investments in a way you perhaps never thought possible.

Now, aren't you glad you told your old boss to take that job and... well, you know.

And here's some more good news: Even if you *have* worked for the same employer your whole life, there may be similar opportunities for you to optimize your investments.

At Motley Fool Wealth Management, we believe that having the best investment strategy consists of more than just holding stock in great businesses (although that's obviously a very solid start!). The best investment strategy for you means holding those great businesses in the most efficient way possible.

Okay, but how many ways can you hold an investment anyway?

Well, there are generally three buckets — taxable (like your brokerage account), tax-deferred (like your 401(k) or IRA), and tax-free (like your Roth IRA). This report from Motley Fool LLC's *Rule Your Retirement* lead analyst Robert Brokamp, CFP® dives into the tax-deferred bucket to show you how you could be saving money paid out in fees every year with a simple technique called an IRA Rollover.

Depending on your personal circumstances, that cash could add up to big bucks that would be pretty foolish to forgo.

But in case this is the first time you're hearing about Motley Fool Wealth Management, just know that we're a Registered Investment Advisor... meaning we actually have a *legal obligation* (known as a "fiduciary standard" in the financial world) to always provide you with financial advice that is in YOUR best interest.

Can you say the same about the person who manages your money?

Meanwhile, we're saving time-strapped Fools just like you hours upon hours of exhaustive research that goes into every buying... selling... and rebalancing decision you make. Freeing you up to actually enjoy the things you spent your entire life wishing you had more time for while you were still working — like taking that trip to the Mediterranean or the Outback that you've always dreamed of... picking up a new hobby or three... or simply spending more time with your kids or grandkids.

So I urge you to take just five minutes or so out of your day to read Robert's informative report below.

To the retirement you've always dreamed of,

Megan Brinsfield

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Why Your 401(k) Could Be Quietly Costing You Thousands — And What You Can Do About It

BY ROBERT BROKAMP, CFP®

A while back, I'm guessing you made a pretty wise decision: You started saving for retirement by contributing to an employer-sponsored retirement account. Regardless of what type you had — a 401(k), a 403(b), a SEP, or another type of plan — you took advantage of some powerful tax benefits and maybe an employer match as well to add thousands of dollars… even *hundreds* of thousands… to your portfolio.

However, if you still have retirement accounts with former employers, you may actually be *losing* thousands of dollars compared with what you could have if you had initiated a tax- and penalty-free rollover to an IRA.

Because you potentially could have a wealth-devouring mix of higher costs, bad investments, and limited choices, and general Wall Street greed might be enriching other people's retirements… at the expense of *yours*.

Of course, while you're still working for the employer, you often have to keep the money in the plan. However, many plans permit current employees to roll money over to an IRA via a so-called "in-service distribution." There might be restrictions, such as the employee must be age 59½ or older. But it's worth asking your HR department about.

As for accounts with former employers, there's no doubt about it: You can roll over that money to an IRA without paying any taxes or penalties. Here are four reasons why doing so could add tens of thousands of dollars to your portfolio.

1. 401(k)s Aren't Free

Your boss deserves a lot of credit for offering a retirement plan. Here's why…

The whole enterprise adds to the workload of the accounting and HR departments. Plans are subject to regulations from the Department of Treasury, the Department of Labor, and the IRS. They must be regularly audited. And reports must be sent to the proper authorities, as well as made available to employees.

This all costs money. And in three-fourths of plans surveyed by the Investment Company Institute (ICI), employees share in those costs. That percentage goes up for *former* employees, since they're often charged fees that the boss is willing to cover for current workers.

These costs range from less than $200 annually per participant to more than $500, depending on the size of the plan. The bigger the plan, the lower the expenses per employee… since the costs are spread over more accounts. That's money you would not have to pay — year in and year out — if you rolled the assets over to one of the many IRA providers that don't charge annual fees or waive them for investors with a certain level of assets.

2. Limited Choices

The typical 401(k) offers a menu of 20 mutual funds. Don't like your choices? Too bad. Want to buy individual stocks, bonds, CDs, ETFs, or other funds? Too bad. You're stuck with the investment options that someone, somewhere put in your plan. While plan trustees are held to a fiduciary standard, the choices they make may not be the ones that you would.

Now, a very small minority of plans offer a brokerage account within the 401(k), which allows for a lot more investment flexibility. But they also often charge higher commissions and fees than the typical discount broker.

3. Poor Performance

A menu of 20 mutual funds might be fine for many investors… if they were great investments.

Unfortunately, most are actively managed funds. You know, the kind that pay a team of managers and analysts to pick the best stocks for the fund. Unfortunately, these well-educated and well-paid people usually don't get the job done. According to Vanguard, less than one-quarter of actively managed equity funds have actually outperformed a relevant benchmark (such as the S&P 500 index) over the past 20 years.

Put another way, the investors in the other 75%-plus of funds would have been better off just investing in the benchmark itself. This can be easily done via an index fund, which does nothing but copy-cat an index, and charges very low fees in the process.

Those fees are among the chief culprits when it comes to active funds' underperformance. They cost, on average, almost *10* times more each year than index funds. Plus, 20% of the fund assets in 401(k)s charge some kind of sales commission or annual marketing fee, according to the ICI.

Fortunately, most retirement plans offer two to four index funds. But that still means that the majority of funds in a 401(k) are actively managed. According to a joint report from the ICI and Brightscope, just 23.1% of 401(k) assets are in index funds.

We don't mean to disparage all actively managed funds. There are plenty of really good ones. But if your 401(k) offers a menu of mostly actively managed funds, you might find better investment options in an IRA.

4. Making You Money May Not Be the Main Motive

Employers hire companies (formally known as "trustees") to handle the nuts and bolts of operating a 401(k) — e.g., record-keeping, sending out statements, making sure the money that is taken out of employees' paychecks gets invested. That company can be a bank, a brokerage, a mutual fund company, or some other financial services firm. That company likely also makes the decisions about which funds go into the 401(k).

Unfortunately, while trustees have a fiduciary duty to the members of their plans — which, as a reminder, means they are legally obligated to act solely in their members' interests — in the cases when the trustee *also* happens to be a company that sells mutual funds, there's evidence that some might be showing a bias toward their own funds. A study from the Center for Retirement Research at Boston College found that such trustees boot out 25.5% of underperforming funds from other companies, but just 13.7% of dud funds from their own company. The study also found a tendency of companies to add their own funds relative to other options.

Here's a funny story: Current and former employees of Fidelity — the largest provider of retirement plans in America — sued their employer for including too many higher-cost Fidelity funds in their 401(k), as well as charging too much in other fees. Think about that: People who work for the biggest player in the retirement-savings marketplace found fault with their very own plan. The suits were settled in 2014 in favor of the employees.

When to Stay With Your 401(k)

Not everyone would be better off by rolling over their retirement savings to an IRA. Here are some of the factors that should make you think twice about switching.

Your plan provides super-low-cost funds: Many plans have access to dirt-cheap funds that aren't available to individual investors.

Your plan has solid and regularly monitored investments: Perhaps the folks who choose the investments in your 401(k) are on top of their game, and you're comfortable delegating the job of selecting funds to them.

Your past employer covers all the administrative costs of the plan, including for former employees.

You hold company stock in your plan: Deciding what to do with company stock can be tricky, so seek out professional help. But you can still roll over the other assets in your 401(k) to an IRA.

Your plan offers attractive investments not available outside the plan: Some 401(k)s offer investments that are designed just for that company. Others offer cashlike or bondlike investments that have higher yields than options outside of the plan.

Putting a Price on Sticking With Your Ex-Employer's Plan

Let's consider how much less someone could have if they kept their money in their old plan rather than rolling it over to an IRA, based on the following assumptions:

- The investor starts out with $250,000 in the account.
- The pre-expense return of the portfolio is 10.1% a year, which is the annualized return of large-cap U.S. stocks from 1926-2014, according to Ibbotson Associates.
- The assets are invested 23.1% in a large-cap U.S. blend index fund that charges 0.17% annually.
- The rest of the money is invested in actively managed U.S. large-cap blend funds, which underperform their benchmark by 1.12% a year (as such funds did over the 10-year period ending on Dec. 31, 2014, according to Vanguard).
- The plan charges $300 annually in administrative costs.
- The investments in the rollover IRA consist entirely of index funds, which also charge 0.17% annually and earn a pre-expense return of 10.1% annually. The account doesn't charge an annual fee.

And the verdict is...

Years	Kept in 401(k)	Rolled Over to IRA	Difference	% More in IRA
5	$386,438	$401,348	$14,910	3.9%
10	$598,527	$644,321	$45,794	7.7%
15	$928,333	$1,034,388	$106,054	11.4%
20	$1,441,385	$1,660,598	$219,213	15.2%
25	$2,239,798	$2,665,911	$426,113	19.0%
30	$3,482,771	$4,279,833	$797,062	22.9%

I don't know about you, but having an extra few tens of thousands of dollars (maybe even hundreds of thousands!) looks pretty appealing to me.

Of course, your mileage will vary, depending on your old plan and the size of your account. You might have contributed to an above-average 401(k)... or one that *really* stinks.

Also, we assumed that the money in the rollover IRA was invested in index funds. However, recall that the biggest benefit of a rollover IRA is that your investment options expand from 10 or 20 to thousands, including individual stocks. And with some savvy selection, you personally might be able to do even better than index funds.

THE FOOLISH BOTTOM LINE

Megan here again!

At the beginning of this report, you were commended for contributing to your 401(k), 403(b), SEP, or whatever plan you had available to you. Then, the rest of the report was spent disparaging such accounts. But make no mistake: Contributing to a 401(k) or other employer plan makes a lot of sense, especially given the tax breaks and possibility of an employer match.

However, employer-sponsored plans aren't perfect, and many Americans have gotten the message. According to the ICI, nine of 10 new traditional IRAs are rollovers from work-related plans.

If you decide to join them, make sure you understand from the new IRA provider how to get the rollover done properly to avoid any taxes or penalties. They'll be quite happy to help.

The Motley Fool LLC has always encouraged investors to take control of their portfolios — and build a bulwark against the financial services industry that will take a piece of your portfolio every chance it gets. Rolling your money over to an IRA from a mediocre (or worse) employer-sponsored plan may be an excellent way to Foolishly declare your financial independence.

And as a client of ours here in Motley Fool Wealth Management, you'd be among a very small and select group of Fools who will actually have the opportunity to put our highly trained in-house team of Certified Financial Planners to work for you at incredibly affordable rates (full details on the entire list of financial planning services we can provide can be found immediately after you join us).

As you've also likely heard by now, not only would you have a dedicated team of portfolio managers (all of whom cut their teeth coming up through the investing ranks of The Motley Fool LLC before moving on to work for Motley Fool Wealth Management) managing your portfolio for you, including what you hold, buy, and sell...

But through the use of technology, the Fool Wealth team will actually be able to custom-build you a diverse portfolio made up of both stocks and bonds — all directly tailored to your unique investment interests... financial situation and goals... and risk tolerance, and all fully managed by Motley Fool Wealth Management with the same Foolishly inspired investment philosophy you've come to know and trust over the years from The Motley Fool.

If that sounds like something you'd be even remotely interested in hearing more about, I urge you to go to the Fool Wealth home page for a slew of explanatory videos, additional insightful reports such as this, a comprehensive FAQ section, and other 100% free and informative content all geared around our exciting Motley Fool Wealth Management offering.

Please just remember one thing: To make 100% certain that should you decide to join us as a client today, you have absolutely everything you need to take advantage of this offer and get your very own portfolio from Motley Fool Wealth Management up and running with a minimum amount of time and effort required on your part, we are making our expert team of Certified Financial Planners available to guide you through the account opening proccess should you need it.

If you're ready to save yourself the time, hassle, and stress of managing your portfolio... and you'd like our dedicated team of porftolio managers to do the heavy lifting for you, simply go ahead and click here to join us today!

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