Why It's Important To Take an Interest in Retirement Plan Fees Again…Or For the First Time

As investors start cautiously peeking at their investment statements again, it's a good idea to take a renewed interest in investment fees and sales charges they pay to their personal retirement plans as well as those at work.

Why? Because most individuals never take the time to learn about what they're being charged in good economic times. In a continuing economic slump, however, every nickel charged to an account provides a teachable moment.

Many of these are fees you don't see in your monthly statement, but they definitely affect what your company collectively pays for its retirement program whether it is a traditional defined benefit plan or a defined contribution plan like a 401(k). But thanks to a move by the U.S. Department of Labor in mid-July, employer plan managers are now going to have greater access to information about fees and charges they're paying so they can make more informed comparisons between plans they're considering for employees.

But that's not all. There is a second set of rules being reviewed by the Labor Department that will affect individual investors. Once approved, all 401(k) investors will be able to see what each individual mutual fund or related investment they've chosen for their retirement fund actually costs in fees.

There's also a transparency move affecting many of the mutual funds we invest in ourselves. In late July, the Securities and Exchange Commission proposed rules that would let the "no load" mutual fund business charge 12b-1 fees that are generally used to cover marketing costs.

It's important to know the various categories of investment fees you pay as well as the ones paid by your employer. Ultimately, they all come out of your pocket. Here are the major fees paid by employers and individuals:

Employer-based plan fees:

Plan administration fees: These are fees that cover basic recordkeeping, accounting, legal and trustee services all defined benefit and defined contribution plans have. But defined contribution plans like 401(k)s, might charge for additional items like live customer service operators, voice-activated customer-service-by-phone systems and various customer and advisor services delivered through the Internet. Many of these fees are deducted from investment returns, but they might also be billed separately.

Investment fees: These go to pay individuals who manage plan investments, and they need to be watched closely based on how much work actually goes into the management function. These amounts are decided generally as a percentage of plan investments, but if a plan is invested largely in indexed investments that don't require as much active management, the fees that the company pays should generally be lower.

Individual service fees: If an employee borrows from their 401(k), there's likely to be a fee for that. Make sure your employer is particularly clear about these fees among all the others.

Mutual fund fees:

Sales charges: Also known as loads and commissions, these amounts are transaction costs you pay for buying and selling shares in a mutual fund. Some of these fees are paid when you invest which you'll hear referred to as a front-end load, or when you sell, which are fees known as back-end loads. You'll also hear terms like deferred sales charges or redemption fees – they mean the same thing.

Management fees: You'll hear these referred to as account maintenance fees or investment advisory fees. These charges cover the cost of managing the fund and are expressed as a percentage of total assets. When comparing mutual funds to invest in, it makes sense to compare fees as you compare performance. You'll also hear about 12b-1 fees, which may cover everything from broker commissions to marketing expenses. 12b-1 fees are currently under review from the Securities and Exchange Commission, which is seeking to make the purpose of these fees clearer. In some cases, funds referred to as "no-load" might instead charge a 12b-1 fee.

Annuity fees: Annuity products often feature sales expenses, mortality risk charges and account management charges. You might also see surrender and transfer charges when an employer terminates the investment in a particular part of its retirement plan or when an individual withdraws an amount from his or her annuity contract.

August 2010 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Capital Strategies, Inc., a local member of FPA.