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Not all retirement plans equal

401(k) ADVISER

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For an increasing number of American workers, a 401(k) will be their primary source of income in retirement. Recognizing this, Congress passed new legislation that encourages employers to increase the number of employees taking advantage of their 401(k).

All the attention 401(k) plans are receiving these days has overshadowed the fact that all 401(k) plans are not created equal. Because employers are not required to offer a 401(k), much less offer specific features, there is a huge gap between the best and worst run 401(k) plans.

Some companies seem content to get by with a bare bones plan that changes infrequently, while other companies devote substantial time and resources to their 401(k) plan.

How can you tell if your 401(k) is on the cutting edge or still in the Stone Age? Here are some signs to look for.

Generous match

Companies have only so much money available to spend on employee benefits. How much they spend on 401(k) contributions tells a lot about their priorities. According to Vanguard, the average midsize to large company contributes 3% of pay to each employee’s 401(k) account. Companies with additional retirement programs, such as pension or profit sharing plans, are likely to match less on 401(k) contributions. But for those where the 401(k) is the only retirement program, matches as high as $7 for every $1 contributed are not unheard of.

Investment advice

Employee benefit surveys routinely show that one of the most often requested employee benefit enhancements is help with retirement plan decisions. That’s because most 401(k) participants struggle with questions like "How much should I save?" "Where should I invest?" or "Tax-deferred vs. tax-free compounding?" Recent law changes encourage employers to make individual 401(k) advice available, yet the latest 401(k) industry statistics show less than half of employers do.

Roth

With a Roth 401(k) account, you give up the tax deduction for your contribution but gain a lifetime of tax-free investment returns and distributions. For those in a low tax bracket, those who would like to accumulate retirement savings that will not be subject to the age 70 1/2 mandatory distribution rules, or those who simply worry about increasing taxes, a Roth account may make sense for you. Even though this feature is virtually free to add to a 401(k) plan and is available to everyone regardless of income, it’s amazing that only one-third of 401(k) plans offer a Roth account.

Low-cost funds

There’s an old saying in business, when you buy in bulk, you get a discount. By definition, 401(k) plans are institutional investors and should not be paying the same investment management expenses that individual investors are forced to pay. Yet many companies are content comparing the expense ratios of the funds in their 401(k) to retail industry averages published by companies such as Morningstar and Lipper. The Morningstar average expense ratio for diversified large-cap U.S. equity funds is 1.27%, while the average expense ratio for the same category of institutionally priced funds that we follow is 0.74%.

Fee disclosure

Trying to understand the investment and administrative fees you pay when participating in a 401(k) plan can make you feel like you’re playing the game "Where’s Waldo." Companies serious about following best practices in the area of 401(k) fee disclosure are moving away from the "just read the prospectus" approach, and providing employees with an individualized summary of their approximate total plan investment and administrative costs.

Automatic features

A healthy percentage of American workers know they need to save and invest for retirement, but lack the time, motivation or knowledge to do so. To help this group, employers are adopting a new 401(k) plan design that automatically enrolls, invests and increases deferral percentages for anyone who fails to make an election. Automating the entire process is proving to be an effective plan design strategy to help those who can’t seem to help themselves. It is estimated that by early 2009, nearly 40% of plans will have adopted one or more of these automated features.

If some of these features are missing in your 401(k) plan, it may be because your employer is not aware they exist or they may think nobody cares. If any of these 401(k) advancements appeal to you, make it your job to enlighten them.

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