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Why you need to take aim at fees

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The keys to achieving a financially secure retirement are diligent saving, disciplined investing and controlling costs. If you accomplish all three, the chances of meeting your retirement savings goals are high.

While saving and investing strategies get the most attention, strategies to control fees can also make a big impact. One strategy everyone should follow: eliminate as many asset-based fees on your retirement savings as possible.

An asset-based fee is a perpetual fee that is charged as a percentage of your account value. Eliminating an asset-based fee of one-half of 1% will save more than $130,000 for a hypothetical investor who saves on average $8,000 a year over a 45-year career and is able to average a 7% rate of return.

For most, your employer's retirement plan represents your largest investable pool of assets. Starting there to understand your fees is a critical step in learning how to control them. Plan fees are separated into three types: investment, administrative and advisory. These fees are often asset-based, or charged as percentage of your account.

Your employer is charged with negotiating a competitive fee for all plan services and making sure these fees remain reasonable. Therefore, your employer is the best place to go for a summary of your plan's fees.

Armed with this information, you can evaluate your employer's plan cost vs. your alternatives. This analysis becomes especially important once you become eligible for a distribution from your plan and begin considering proposals from wealth managers wanting you to roll your plan assets into an IRA.

Years ago wealth managers stopped pushing commission-based products and started pushing asset-based fee arrangements that often range between 1 and 2% of your total portfolio annually.

This business model has the benefit of discouraging account churning but has the disadvantage of generating recurring fees that may seem reasonable at first but often become unreasonable over time as your account increases in value.

To attract new clients, some wealth managers use clever slogans to camouflage their expensive asset-based fee arrangements. They say, "We only do better if you do better." They fail to mention, "If you lose money, we still make money" and "We get paid an ever-increasing fee for the same amount of work."

Others pitch, "We're a fiduciary and don't sell investment products." The truth is they don't sell products because it's much more profitable to sell a service that siphons an ever-increasing amount of money out of your total account forever.

My advice is to pay your wealth manager based on an hourly rate for their professional advice, just like you pay your accountant or attorney. While it may be the industry standard today to pay an asset-based fee for wealth-management services, don't fall for the "everyone else is doing it" reasoning. I predict that within 10 years, as more wealth management services become automated with AI, paying an hourly rate for wealth management advice will become the industry standard.

Choose from the hundreds of registered investment advisers who currently accept hourly compensation for their advice. If you don't, you're likely to end up paying a wealth manager up to three times more to manage your IRA than if you left your assets in your 401(k) where you benefit from institutional pricing and professional oversight.

More employers have fallen for the 401(k) industry's latest ploy to pad its bottom line by offering a managed account service. These model portfolios are billed as custom-made to the individual, for which they tack on an additional 25-50 basis points in cost. This cost is added on top of the investment-management fee of the underlying mutual funds, often increasing your total cost by 30 to 100%.

Plan sponsors should know better, but the service providers pushing these accounts are quite persuasive. They do a good job making managed accounts, which is really a program motivated to increase their bottom line, sound like it's in your best interest. Stick with a well-managed target-date fund and you will often enjoy better results with meaningfully less expense.

Diligent saving and disciplined investing will set you on the right path, but serious savers also remain focused on eliminating unnecessary costs. By understanding the cost structure of all your alternatives, you will help maximize the amount waiting for you at retirement.

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