

# 1

## Step One: Understanding the REAL and HIDDEN Expenses You Pay

**M**ost Americans either do not know what they are paying within their retirement plan or, even worse, make the completely erroneous assumption that they aren't paying anything at all. While it is absurd to think this, all one has to do is look at the typical retirement plan statement produced for each participant, and it becomes easy to see why so many people have no idea what they are paying **or often don't even realize there are any expenses!** THE TYPICAL RETIREMENT PLAN STATEMENT EFFECTIVELY HIDES FEES YOU PAY FROM YOU! Believe it or not, this is legal! It may not be ethical, but it is legal. As of this writing, the Department of Labor has proposed some new regulations that would potentially solve some of these problems, but the experts I have consulted with on these regulations remain skeptical whether the impact will necessarily mean fuller and more understandable disclosure in practice. For now, we will assume your statement might look like what retirement plan product vendors have been able to get away with for years.

I've included a copy of one of my own 401(k) statements in Appendix B so you can see every little detailed disclosure. Your

statement probably looks pretty similar. This was the standard statement that came from the Principal Group (our company's former 401(k) vendor before I fixed my company's plan, which is how I know that far lower cost alternatives are available). The Principal Group is no small outfit and can afford to do decent record keeping. According to *Pensions & Investment Age*, the Principal Group had over 2.7 million participants getting similar statements from over 32,000 different sponsoring companies. Think about this. The number of companies whose 401(k) plan provides this sort of statement is FIVE TIMES the number of all public companies in the United States!

But if one were so possessed to look beyond the first page of my statement (Figure 1.1) that shows the bottom line of what any participant is interested in (i.e., how much money you have), where would one search for expenses? How about the details of the statement entitled "account activity"?

The account activity section of my statement supposedly details the financial activities and even has a column heading that includes the word *expenses* (Table 1.1).

## Is It Any Wonder Some People Think They Have No Expenses?

Here I am reviewing what on the surface appears to be a detailed accounting of my 401(k) balances. I see beginning values. I observe \$17,500 in additions (my contribution plus my employer's match). I see that *\*Net Earnings* has a little asterisk, which, in the financial services industry in general and particularly in retirement plans, means "we are trying to hide something from you." If I read the footnote, it clears things up perfectly for me. Well, not so much. All it says is that the net earnings reflect plan expenses as well as—

Let's get this straight! I have a column that says "net earnings" (footnoted as net of expenses), which means they are mixing up returns with expenses even though they have another column where they could easily break out the expenses.

That expense column is footnoted, too, this time with the number 2. Like an asterisk, anything footnoted is likely to mean someone is attempting to hide something from you, because few people read footnotes. **Read the footnote.** All it says is that it *may include* the same things that are listed in the column heading! I guess it *may exclude* it, too, since it says ZERO.

PERSONAL & CONFIDENTIAL  
WILLIAM  
[REDACTED]  
[REDACTED] STREET  
RICHMOND, VA 23220-5048

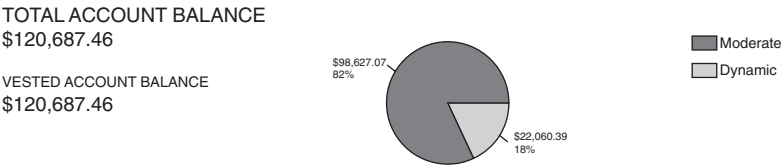
401(K) PLAN

DAVID [REDACTED]

Contract Number 4 [REDACTED]  
Date of Birth: 12 [REDACTED]  
Date of Employment: 05/07/1999  
  
Identification Number  
XXX-XX-[REDACTED]

Here is a summary of retirement account information from January 1, 2005 to December 31, 2005.

ACCOUNT BALANCE	TOTAL ACCOUNT BALANCE BY RISK CATEGORY
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PERSONALIZED RATE OF RETURN

**For the report period 01/01/2005–12/31/2005 = 8.02%**

This is the percentage change, weighted for transactions, of individual investment options and this retirement plan portfolio over the time period of this report. It takes into consideration deposits, transfers, withdrawals, fees, and unit value changes or interest credited at the time of the calculation. Past results do not predict future results.

Please see page three of this statement for performance information on each of the investment options you have available. For more details about these investment options, including comparisons to benchmarks, portfolio holdings, etc., visit The Principal Retirement Service Center® at [www.principal.com](http://www.principal.com).

MESSAGE BOARD

- You will notice some recent changes to your statement. We responded to your valuable feedback and have added a column to the Account Activity by Investment Option to display the Investment Advisor. The Investment Advisor is the company that manages the investment option. Your awareness of the strong business relationships we have with these Investment Advisors is important to us as we help you reach your retirement goals. The amounts which were previously displayed in the Transfers column have been combined in the Additions/Transfers In and Withdrawals/Transfers Out columns.
- Sign up today to view your retirement plan statements online! By accessing your statement online, you'll be able to easily and quickly retrieve desired information about the employer's retirement plan with the click of a mouse. You will also have access to an archive of past statements, as well as the many other tools available through The Principal Retirement Service Center®. Visit [www.principal.com](http://www.principal.com) to sign up!

Please review this statement and notify us of any discrepancies within 90 days. After 90 days, corrections will be made on a current basis.



Figure 1.1 Cover Page of a 401(K) Statement—the Bottom Line

Table 1.1    Account Activity Section of a Statement

ACCOUNT ACTIVITY BY INVESTMENT OPTION AS OF 12/31/2005						
INVESTMENT ADVISOR	INVESTMENT OPTION	Beginning Balance	Additions/ Transfers In <sup>1</sup>	*Net Earnings	Withdrawals/ Expenses/ Transfers Out <sup>2</sup>	Ending Balance
Principal Global Investors	Moderate Total Market Stk Idx Sep Acct+	\$79,413.38	\$14,875.12	\$4,338.57	\$0.00	\$98,627.07
Principal Global Investors	Dynamic Diversified Intl Sep Acct+	\$13,069.14	\$2,274.95	\$3,515.85	\$0.00	\$18,859.94
Principal Global Investors	Intl Emerging Mkts Sep Acct+	\$2,048.72	\$349.93	\$801.80	\$0.00	\$3,200.45
TOTALS		\$94,531.24	\$17,500.00	\$8,656.22	\$0.00	\$120,687.46

Detailed transaction activity is available on the web at [www.principal.com](http://www.principal.com).

<sup>1</sup>May include deposits and transfers.

<sup>\*</sup>Net earnings reflect plan expenses as well as the timing and amount of deposits to the account.

<sup>2</sup>May include withdrawals, transfers, and expenses.

Because the numbers in the expense column are zeros, it appears as though there are no expenses. Look at my full statement in Appendix B, or better yet, look at your own retirement plan statement and see if yours is equally misleading. You are probably one of the millions of Americans who receives a misleading statement that has only zeroes in the expense column of your statement.

Maybe I’m not your average Joe, and I know those funds that I invest in have expense ratios. They might be “no load,” which in today’s world often means that the fund doesn’t confiscate a big chunk of YOUR money from you all at once up front. Instead, often such “no loads” will take a little bit at a time forever and try to hide it from you unless you look for it. I call these “constant load” funds. So I keep paging through my statement, and sure enough there is a page that shows me information about all of the alternatives in my 401(k) plan (see Table 1.2).

See if you can find what expenses are in this section. **YOU CAN’T BECAUSE EXPENSES ARE ONCE AGAIN NOT SHOWN!** If you scan Table 1.2 closely for the word *expense* or *expenses*, you will observe that the last sentence in the introductory paragraph says, **“All returns displayed here are after Total Investment Expense, but before any plan expenses, of the investment option.”**

**Table 1.2 A Section of the 401(k) Statement Showing Investment Options**

INVESTMENT PERFORMANCE THROUGH 12/31/2005										
INVESTMENT ADVISOR	INVESTMENT OPTION	YTD	Last Calendar Quarter	1 Yr	3 Yr	5 Yr	10 Yr or *Since Inception	Inception Date	NAV/ Unit Value	
	<b>Stable</b>									
	Guaranteed 5 year	3.95	---	---	---	---	---	---	---	---
Principal Global Investors	Money Market Sep Acct+	2.72	0.87	2.72	1.45	1.96	3.64	12/10/1980	45.3369531	
	<b>Conservative</b>									
	Bond and Mtg Sep Acct+	2.48	0.62	2.48	4.12	6.04	6.30	02/01/1983	735.7602015	
	<b>Moderate</b>									
American Century Inv. Mgmt.	LgCap Value II SA+	5.83	1.61	5.83	---	---	*5.81	12/31/2004	10.5828814	
Principal Global Investors	Lg Cap Sdk Idx Sep Acct+	4.58	2.00	4.58	13.99	0.16	8.66	01/01/1990	47.0805293	
Principal Global Investors	Total Market Sdk Idx Sep Acct+	5.33	2.03	5.33	14.83	1.05	*1.81	09/28/1999	11.1817384	
	<b>Aggressive</b>									
American Century Inv. Mgmt.	LgCap Growth II Sep Acct+	4.58	3.31	4.58	12.91	-2.63	*-2.62	12/29/2000	8.7541287	
Mazama Capital Management	SmCap Growth III Sep Acct+	12.50	8.04	12.50	---	---	*13.31	06/01/2004	12.1930230	
Mellon Equity	MidCap Growth I Sep Acct+	13.43	4.18	13.43	20.43	-5.15	*-10.49	12/31/1999	19.6066484	
Principal Global Investors	Mid-Cap Sdk Idx Sep Acct+	12.20	3.23	12.20	20.63	8.11	*10.90	08/31/1999	19.2818973	
Principal Global Investors	Small Co Growth Sep Acct+	4.35	2.64	4.35	22.22	1.61	6.00	06/01/1995	19.2785040	
Principal Global Investors	Sm-Cap Sdk Idx Sep Acct+	7.29	0.29	7.29	21.89	10.27	*11.66	08/31/1999	20.1305345	
	<b>Dynamic</b>									
Principal Global Investors	Diversified Intl Sep Acct+	24.14	5.75	24.14	26.17	5.16	8.53	05/20/1987	49.3574051	
Principal Global Investors	Intl Emerging Mkts Sep Acct+	35.09	7.54	35.09	38.94	18.87	11.99	01/01/1995	33.3525171	

These results are for the investment options selected by your company's plan, and may be different from the results for other plans.

+ For, more information about this investment option, including its full name, please Visit The Principal Retirement Service Center® at [www.principal.com](http://www.principal.com) or call [REDACTED]

So here again, **they are hiding expenses in the returns.** They are also tipping you off, though, that there may be other expenses, *because these returns are before plan expenses.* This helps defend them from class action lawsuits, because if you and your coworkers try to sue them for their misleading participant statement, they can claim that they said there were other expenses. As far as you can tell from my statement (and probably yours, too), it looks as though I'm paying ZERO in expenses.

I had just over \$120,000 in this plan as of this statement date. Want to venture a guess as to what my REAL expenses were? *Hint:* They WERE NOT ZERO!

**MY annual expense for the next year, based on just my current balances would be: \$1,566! THIS IS A LOT DIFFERENT THAN ZERO!!!**

You should note that 82 percent of my allocation was in a Total Market Index Fund that, according to the 401(k) web site, had 0.31 percent in annual expenses. How did my total expenses end up at \$1,566 or almost 1.3 percent? I'll show you how to figure it out. It is unlikely that your statement is going to be of much value in doing so because, as we have seen, it is standard practice to hide the fees from appearing on your statement. And it is legal, but in my opinion it is NOT ethical.

## **How to Find Your REAL Expenses**

If your statement isn't showing your expenses, you are probably wondering how you will figure out what you are really paying. You have a couple of choices.

### **Option 1: Find Your Expense Ratio**

If you are anxious to quickly determine your costs, you can usually get the answer for at least some of your expenses by just taking a few minutes to go to your retirement plan web site and look for the **expense ratio** for each fund you own. It may be shown in a table of performance information like Table 1.2 but with an additional column entitled either "Expense Ratio" or "Total Investment Expense." There may be links to other web sites like Morningstar.com that will show you the expense ratio of your fund. You may even have a fact sheet from your original enrollment materials that summarizes this information,

or such a sheet may come with your quarterly or annual statement that includes the expense ratios. As a last resort, if you can't find this information in any of those places, you can look up each fund you own on a web site like Morningstar.com or Yahoo! Finance.

The expense ratio will be reflected as an annual percentage expense like 0.85 percent or 1.25 percent. For each fund you look up, record the expense ratio next to the balance you own of that fund on your statement (see Figure 1.2). See, the statement is useful for something! How long this process takes, whether 10 minutes or 20 minutes, is somewhat dependent on the number of funds you have to research and how deeply the information is hidden from you.

Once you know the expense ratio for each of your funds, use a calculator or drop the information into a spreadsheet and multiply the expense ratio by your ending balance as shown in Figure 1.3.

Finally, to figure how your expenses are combined based on your fund selection, add the dollar amount of the expenses for all of the funds as above, and divide by your total ending balance (see Figure 1.4).

Now, this figure does not tell you ALL of your expenses—it just shows some of the expenses that may be hidden within the funds. **It specifically DOES NOT show you the “plan expenses” as mentioned in that little footnote we saw earlier.**

ACCOUNT ACTIVITY BY INVESTMENT OPTION AS OF 12/31/2005							Your Research
INVESTMENT ADVISOR	INVESTMENT OPTION	Beginning Balance	Additions/ Transfers In <sup>1</sup>	*Net Earnings	Withdrawals/ Expenses/ Transfers Out <sup>2</sup>	Ending Balance	
Principal Global Investors	Moderate Total Market Stk Idx Sep Acct+	\$79,413.38	\$14,875.12	\$4,338.57	\$0.00	\$98,627.07	0.31%
Principal Global Investors	Dynamic Diversified Intl Sep Acct+	\$13,069.14	\$2,274.95	\$3,515.85	\$0.00	\$18,859.94	1.06%
Principal Global Investors	Intl Emerging Mkts Sep Acct+	\$2,048.72	\$349.93	\$801.80	\$0.00	\$3,200.45	1.51%
<b>TOTALS</b>		\$94,531.24	\$17,500.00	\$8,656.22	\$0.00	\$120,687.46	

Detailed transaction activity is available on the web at [www.principal.com](http://www.principal.com).

<sup>1</sup>May include deposits and transfers.

\*Net earnings reflect plan expenses as well as the timing and amount of deposits to the account.

<sup>2</sup>May include withdrawals, transfers, and expenses.

**Figure 1.2 Recording the Expense Ratio for Each Fund You Own Based on Your Research**

ACCOUNT ACTIVITY BY INVESTMENT OPTION AS OF 12/31/2005							Your Research
INVESTMENT ADVISOR	INVESTMENT OPTION	Beginning Balance	Additions/ Transfers In <sup>1</sup>	*Net Earnings	Withdrawals/ Expenses/ Transfers Out <sup>2</sup>	Ending Balance	
Principal Global Investors	Moderate Total Market Stk Idx Sep Acct+	\$79,413.38	\$14,875.12	\$4,338.57	\$0.00	\$98,627.07	0.31% = \$305
Principal Global Investors	Dynamic Diversified Intl Sep Acct+	\$13,069.14	\$2,274.95	\$3,515.85	\$0.00	\$18,859.94	1.06% = \$199
Principal Global Investors	Intl Emerging Mkts Sep Acct+	\$2,048.72	\$349.93	\$801.80	\$0.00	\$3,200.45	1.51% = \$48
TOTALS		\$94,531.24	\$17,500.00	\$8,656.22	\$0.00	\$120,687.46	

Detailed transaction activity is available on the web at [www.principal.com](http://www.principal.com).  
<sup>1</sup>May include deposits and transfers.  
<sup>\*</sup>Net earnings reflect plan expenses as well as the timing and amount of deposits to the account.  
<sup>2</sup>May include withdrawals, transfers, and expenses.

**Figure 1.3      Calculating the Dollar Cost of Your Expense Ratios**

ACCOUNT ACTIVITY BY INVESTMENT OPTION AS OF 12/31/2005							Your Research
INVESTMENT ADVISOR	INVESTMENT OPTION	Beginning Balance	Additions/ Transfers In <sup>1</sup>	*Net Earnings	Withdrawals/ Expenses/ Transfers Out <sup>2</sup>	Ending Balance	
Principal Global Investors	Moderate Total Market Stk Idx Sep Acct+	\$79,413.38	\$14,875.12	\$4,338.57	\$0.00	\$98,627.07	0.31% = \$305
Principal Global Investors	Dynamic Diversified Intl Sep Acct+	\$13,069.14	\$2,274.95	\$3,515.85	\$0.00	\$18,859.94	1.06% = \$199
Principal Global Investors	Intl Emerging Mkts Sep Acct+	\$2,048.72	\$349.93	\$801.80	\$0.00	\$3,200.45	1.51% = \$48
TOTALS		\$94,531.24	\$17,500.00	\$8,656.22	\$0.00	\$120,687.46	0.45% = \$552 (\$522/\$120,687)

Detailed transaction activity is available on the web at [www.principal.com](http://www.principal.com).  
<sup>1</sup>May include deposits and transfers.  
<sup>\*</sup>Net earnings reflect plan expenses as well as the timing and amount of deposits to the account.  
<sup>2</sup>May include withdrawals, transfers, and expenses.

**Figure 1.4      Calculating the Combined Expense Ratios**

Unless you diligently file away every scrap of information you get, in order to calculate your real total expenses (at least those that are required by law to be accessible to you), you will need to contact your human resources department, controller, payroll, or some other person within your company who provides you with your retirement plan information. The expense ratios we have looked at are merely a portion of what you are likely paying.



The additional statement you are looking for is something you get every year for a 401(k) plan, but is not provided to 457 or 403(b) plans. You probably never pay attention to it, since it doesn't show you anything specifically about your balances. It is normally called something like "Summary Annual Report," and it may expose some HUGE expenses.

Since you are probably going to have to contact your human resources (HR) or benefits department anyway, the second option might be easier for you if you have the patience to wait for them to respond.

### **Option 2: Let Human Resources Do Some of the Work for You**

If you have the patience to wait for a response from your HR/benefits department, the easiest way to understand your costs is to let them collect the information you need to figure it out.

First, make a copy of the page showing the balances of each of your funds from one of your statements, or print out your fund holdings from your retirement plan web site. Then, attach a note that says something similar to the following:

To: Human Resources Dept.

From: MY NAME

Re: My retirement plan

Dear NAME:

I've been doing some retirement planning and I'm trying to get an understanding of the expenses I am incurring in my retirement plan.

I was wondering if you could provide me with two things:

The expense ratios of the funds I own (statement of balances attached)

A copy of the Summary Annual Report for the plan

Thank you for your prompt attention to this matter.

Sincerely,

My Name

Depending on the size of your company and how well you know your benefits department staff, you can obviously make the note more personal and less formal. The bottom line is that you should get two things back from them. The first is the expense ratios of your funds (you will still need to take the steps shown in option 1 to

calculate the dollar cost of those ratios, but at least you won't have to look it up). The other is a document that looks something like Figure 1.5.

If you are in a 401(k) plan, you already get this statement once a year, but you probably do not pay any attention to it, because it does NOT APPEAR to have any information about your particular situation. But on closer inspection, you will find that it does. In the Basic Financial Statement, you can discover how much you are paying beyond the expense ratios, but it requires a little addition, subtraction, multiplication, and division.

First, start at the second paragraph and look for some numbers. Take the plan expenses (in this case, \$46,230) and subtract the amount of benefits paid (in this case, \$34,926). The difference between these two dollar amounts is either going to show up in "administrative expenses" (in this case, \$0) or in "other expenses" (in this case, \$11,304). It does not make any difference how much falls into either category. The bottom line is that you need to take the total expenses and subtract the benefits paid.

<p style="text-align: center;"><b>SUMMARY ANNUAL REPORT</b></p> <p>This is a summary of the annual report for</p> <p>FIN [REDACTED] INC. 401(K) PLAN</p> <p>EIN [REDACTED] 040 [REDACTED]</p> <p>for January 1, 2005, through December 31, 2005. The annual report has been filed with the Employee Benefits Security Administration, as required under the Employee Retirement Income Security Act of 1974 (ERISA).</p> <p><b><u>BASIC FINANCIAL STATEMENT</u></b></p> <p>Benefits under the plan are provided by a combination of funding arrangements. Plan expenses were \$46,230. These expenses included \$0 in administrative expenses and \$34,926 in benefits paid to participants and beneficiaries, and \$11,304 in other expenses. A total of 25 persons were participants in or beneficiaries of the plan at the end of the plan year, although not all of these persons had yet earned the right to receive benefits.</p> <p>The value of plan assets, after subtracting liabilities of the plan, was \$1,341,870 as of December 31, 2005, compared to \$1,013,895 as of January 1, 2005. During the plan year, the plan experienced an increase in its net assets of \$327,975. This increase includes unrealized appreciation or depreciation in the value of the plan assets; that is, the difference between the value of plan's assets at the end of the year and the value of the assets at the beginning of the year or cost of assets acquired during the year. The plan had total income of \$374,205, including employer contributions of \$42,614, employee contributions of \$221,624, gains of \$0, from the sale of assets, and earnings from investments of \$109,967.</p> <p><b><u>YOUR RIGHTS TO ADDITIONAL INFORMATION</u></b></p>
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**Figure 1.5    Summary Annual Report**

This amount could possibly be zero, and it could be a HUGE amount depending on your plan, side deals for what is called “revenue sharing,” and other factors. Revenue sharing is a kickback to the plan to help make up for the excessive fees you pay in the form of the expense ratios. In fact, it is possible that it could even be a negative number if there are a lot of funds providing these kickbacks. We will discuss these more later. The bottom line is that the expense *will* show up somewhere, if you look for it.

In this plan’s case, the difference between the plan expenses and benefits paid was \$11,304. The next step is to figure out *how much of that you paid*. To calculate this number, take the \$11,304 and divide by the total plan value (in this case \$1,341,870, which is found at the beginning of the third paragraph showing the value of the plan at the end of the year). This number (\$11,304 divided by \$1,341,870) is 0.84 percent in this example. Depending on your plan and the revenue sharing side deals, it could be 0 percent (possibly even negative, but not likely) or it could be 2 percent or more.

However, the bottom line is that *this percentage is in addition* to your fund expense ratios. So in my case, in calculating my real total expense, I had to add to my total fund expenses of \$552 (Figure 1.4) and an additional expense shown only in this report of \$1,014 (0.84 percent multiplied by my total account balance of \$120,687). Therefore, my *total real expense* was \$1,566 (\$522 in expense ratios, plus \$1,014 in plan expenses) or about 1.3 percent in assets.

Considering that 82 percent of my portfolio is in a total market index fund, that is a lot of fees! It is 1 percent more than the expense ratio of my fund!

Appendix C shows the original Summary Annual Report of my company’s 401(k) plan with the \$11,304 of excess expenses BEFORE we fixed the plan. That original report is followed by our new Summary Annual Report for 2007 showing how these expenses charged against employees accounts are now only \$582. **THAT IS ALMOST A 95 percent reduction in expenses for our employees. Shouldn’t your employer being doing this for you?**

## Quirks You Might Discover

In the example of my plan, the expense ratios overall were not that excessive (0.45 percent), because I was using a relatively low-cost index fund for most of the portfolio. But the other expenses

were chewing up a lot of my retirement money—almost twice the amount of my investment expense—and were never explicitly disclosed to me unless I did the math on the Summary Annual Report.

Don't be surprised if your expense ratios are much higher than mine, for it is very common to have expense ratios of 0.75 percent to over 2.0 percent. As previously mentioned, in many cases the funds with the higher expenses have another legal but potentially unethical practice of kicking back some of their excessive fees in a practice known as "revenue sharing." **These kickbacks take the excess fees YOU PAY from your fund selection and use YOUR MONEY to pay for EVERYONE ELSE'S costs.** Yes, this is legal. No, I do not think it is ethical. No, it isn't currently disclosed to you anywhere. No, your employer may not even know about it.

If you have expense ratios of 0.75 percent or more, it is likely that your other expenses in the Summary Annual Report will be at least partially or completely defrayed by these kickbacks. This is just swapping money from one bucket into another. In my case, it could have just as easily shown my fund expenses at 0.84 percent instead of 0.45 percent, and my Summary Annual Report might have shown "other" expenses of 0.45 percent instead of 0.84 percent.

Also, do not be surprised if your plan expenses, the sum of your expense ratios and the other expenses in your Summary Annual Report, total more than 2.0 percent in the calculation. I've seen plans with more than \$5 million in assets paying more than that, and for smaller companies, it is more likely to be the norm. **THAT DOESN'T MEAN YOU HAVE TO PAY THAT PRICE!**

In the case of 403(b) and 457 plans, some of these documents and disclosures are likely to be less accessible. Many of these plans bundle mutual funds into an insurance company annuity wrapper. One of the easiest ways to determine the costs you are paying under these products is to simply compare the return for a specific calendar year to what your return was on the fund, and then add the expense ratio of the underlying fund.

For example, if you own Acme Long Term Growth fund as one of the options in your retirement plan, go to Morningstar.com and look up the return over the last year. (It is important that you match the exact one-year time period, so make sure that you are not comparing the one-year period ending in June versus the one-year period in July.) Say Morningstar says the fund had a return of 4.25 percent over the 12 months ending June 30, 2008, including an expense

ratio of 0.65 percent. Now, go to your retirement plan web site, most of which allow you to calculate the return you received on your investments over the last year (it is important that it matches the June 30, 2008, time period you looked up on Morningstar). Say your retirement plan web site calculates the return over the last year for your Acme fund at 3.5 percent. The difference in the returns of 1 percent (4.5 percent less 3.5 percent) means that somewhere in your retirement plan an additional 1 percent expense is coming out of your retirement assets, bringing your total real expenses to 1.65 percent (the fund expense ratio from Morningstar of 0.65 percent plus the 1 percent difference in return).

## Paying for Your Boss's Retirement

If you are one of the unlucky millions of people out there who go through this exercise only to discover your expense ratios are high, but the plan administration and other expenses are relatively low in the plan Summary Annual Report, you could be funding your boss's retirement, or at least the retirement of the person in the next cube.

Say you have \$100,000 in your 401(k) and you discover that your expense ratios total 1.5 percent a year. You also discover that in your plan's Summary Annual Report the difference between total expenses and benefits paid was zero. (It is possible, by the way, for this difference to be even less than zero, and this will still work in the calculation. You just add the "negative expense" percentage of the total plan expenses against your expense ratio, thus reducing your total expense. For example,  $-0.25 \text{ percent} + 2.50 \text{ percent} = 2.25 \text{ percent}$ .)

If your expenses are in this range, there is likely a 0.25 to 0.35 percent kickback (known as a "revenue share") that everyone in your company benefits from! You are such a nice guy!

Here's how it works: For each fund offered to participants, there will be some higher-cost funds with big kickbacks and some funds that do not offer any kickbacks (usually funds with expenses of 0.40 percent or less). The kickbacks, or revenue shares, are not normally disclosed to you, and they may not even be well disclosed to your company. **You normally DO NOT get the benefit of those higher expenses in proportion to *what you paid in expense*.** Instead, everyone (your boss included) gets the benefit of your selecting

expensive funds. The kickbacks from the expensive funds are used to defray the overall cost of operation of the whole plan, and **EVERYONE in your company shares proportionately based on their balance, even if they didn't use ANY of the expensive funds that generate these kickbacks.**

If your plan consisted of just you and your boss, and you selected these expensive funds for your \$100,000, but your boss selected lower-cost funds without the revenue share for his \$1 million balance, you would, in essence, be making a contribution to your boss's retirement fund of \$318 a year. This amount is determined by which funds you select. Expensive funds **charge you personally for these excess expenses, and then they are shared as kickbacks with everyone else in the retirement plan.** The amount that is shared back to others is not based on what the other people paid, but instead it is based on their proportion of the total plan balances, or is spread equally to each individual participant, but never in the proportion paid. Yes, this is legal, too! It is unethical, in my opinion, but it is legal.

If you are like the vast majority of Americans, you will find that your expenses are likely to be over 0.75 percent or more—perhaps much more. If they are less than 0.75 percent, read Chapter 2 to see if you are paying expenses that are even harder to discover than the ones that are required to be disclosed to you. Hopefully, the currently proposed new regulations by the Labor Department will go into effect and this exercise will be somewhat easier.

## **Important Update at Press Time**

Throughout this book, there are references to proposed new regulations that would have improved the disclosure of expenses to participants. Just prior to going to press, the Department of Labor announced that these new proposed expense disclosure rules **WILL NOT** be adopted. This means for the foreseeable future it will continue to be legal for 401(k) vendors to hide expenses from plan participants.