Your Small Practice 401K May Be Ripping You Off – Friday Q&A Series

Q.

I'm a solo physician with several employees. We have a 401K/profit-sharing plan filled with expensive, actively managed mutual funds. We pay an adviser's fee of 1% in addition to mutual fund expense ratios of 1-2%. I would like to reduce the fees by investing in something like Vanguard Target Retirement Funds, while still being able to max out ($51K) the account each year. I'm concerned the adviser, who is also our accountant, may be biased about this. What do you recommend?

A.

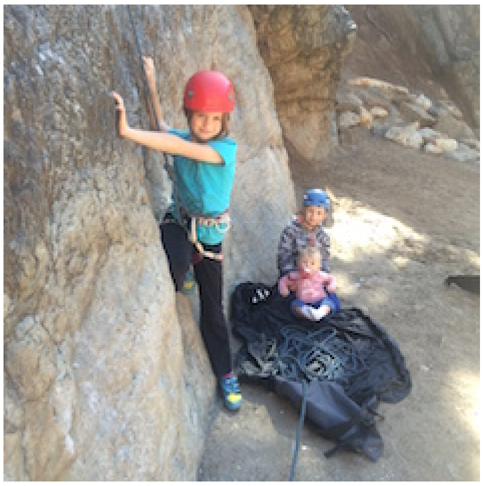
First of all, your accountant/advisor is not only biased but is not acting as your fiduciary either. He is either ignorant of things he should be an expert about (i.e. that's it's not a good idea to invest in high expense actively managed mutual funds) or he is willfully milking you like a cash cow. If he exhibits a similar level of incompetence with regards to your accounting, you probably need a new accountant in addition to a new advisor.

Limited Options for 401(k)/Profit-Sharing Plans

Your options are limited because of your business set-up. If you were an independent contractor or didn't have any employees aside from a spouse, you could use a low-cost Solo 401K or SEP-IRA from Vanguard. If you didn't want to max out the account, you could use a SIMPLE IRA, again through a company like Vanguard. But since neither of those apply to you, you still need a 401K/Profit-sharing plan.

Top-Heavy Rules

Any time you have employees, you have to be very careful about the top-heavy rules. The government has these in place so you can't have a retirement plan for the owners without providing one for the employees. A defined contribution plan is defined as "top-heavy" when key employees have more than 60% of the assets in the plan. A key employee owns more than 5% of the company, owns more than 1% and makes more than $150K per year, or is a key officer and makes more than $165K per year. In a typical practice, the docs are "key employees" and everyone else is not. Given your very small number of employees, typical employee retirement contributions, and your desire to maximize your own contributions, your plan will almost surely be considered "top-heavy."



If you are top-heavy, you have to provide a minimum contribution to your employees as an employer match. In your case, that amount is probably going to be 3% of their total compensation. You may be able to exclude part-time employees and those who have been with you for less than a year from the plan, depending on how your plan is drawn up.

Better 401K Provider

What you need (aside from a new advisor and possibly a new accountant) is a new 401K provider. Perhaps the best one out there right now for a small business like yours is provided by a firm called Employee Fiduciary. This company has been written about by Allan Roth, one of the good guys in the business. He also refers to an article by another good guy, Daniel Solin, calling for 401K reform. Basically, Employee Fiduciary charges low fees and provides good investments. They're not mutually owned like Vanguard, but they're nearly as cheap, and besides, Vanguard won't work with a tiny business like yours.

Employee Fiduciary has very low fees, \$500 to start a new plan or for you, \$1000 to convert an old plan. You would then pay \$1500 a year (plus \$30 a year for each employee above and beyond the 30 employees that the \$1500 covers) plus 0.08% of assets under management. You wouldn't get the advice you're getting now from your advisor, but as near as I can tell, you can’t pay too little for bad advice anyway. You have access to pretty much any investment you desire to put into the plan, including funds from 377 fund families (including Vanguard), all the ETFs on the market, or even a brokerage window run through TD Ameritrade (the same one used by HSA Bank). So all in, it’ll cost you $1000 to change plans, then $1500 a year. Beyond that, you’ll pay 8 basis points to Employee Fiduciary and less than 20 basis points to Vanguard each year. That’s about as cheap as 401K plans get. You can use your current advisor, hire a new one, or not use one at all if you prefer, but any advisory fees you choose to pay will be above and beyond these fees.

Readers, what do you think? Have you reformed your 401K? Have you used Employee Fiduciary? What’d you think? Any other low-cost 401K providers you can recommend? Comment below!