ADMINISTRATION | September 3, 2024

Smaller Plans, Larger Costs

While 401(k) plan fees are a bigger ask for small plans, the savings benefits to participants still tend to be worth the price.

Reported by BETH BRAVERMAN | *Art by* PETE RYAN

While fee compression has broadly pushed down the costs of retirement benefits, basic math still puts smaller plans at a disadvantage. Larger plans benefit from economies of scale, even if they have higher total costs, while fixed costs mean smaller plans pay more per participant.

Total bundled costs, including investment and recordkeeping and administration fees, average 4.16% for plans with 10 participants and $100,000 in assets, compared with 1.62% for plans with 500 participants and $5 million in assets, according to the 2024 edition of the "401(k) Averages Book."

"If you have a small plan with 10 or 20 employees, you still have to do the testing and all that," says Mark Alley, national market president for Alerus. "It doesn't take much more to test a large plan than a small plan."

In addition, providers may be more willing to lower variable costs for larger plans, or for plans with fewer participants and higher balances, since they see a greater potential to cross-sell and realize other revenue opportunities.

There are, of course, other options for small businesses, such as a SIMPLE 401(k) and a SEP individual retirement account. At some providers, there is no cost to set up those plans for the employer. But for smaller businesses that may not have an adviser, parsing the fee nuances can be a challenge.

"We see a general confusion and folks are overwhelmed because there are a number of different options available," says Roger Morrissette, vice president of small business retirement products at Fidelity.

To help, Fidelity has created a "Plan Selector" tool that employers can use to understand how their plan options differ from each other.

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SECURE Impact

For plan sponsors looking at a 401(k), experts say that 2019's Setting Every Community Up for Retirement Enhancement Act and the SECURE 2.0 Act of 2022 have helped reduce the cost burden via both tax credits for new plans and support for pooled employer plans, which allow even smaller employers to take advantage of economies of scale, while also outsourcing some of the fiduciary risk and time required to run a plan.

For the first three years of a new plan, employers with fewer than 100 employees can get a tax credit of up to $5,000 per year, with an additional $500 for setting up automatic enrollment and a $1,000-per-employee credit for matching contributions made to non-highly-compensated employees.

"Some of the more successful PEPs are leveraging that tax credit to allow small employers to maybe start up a plan with no cost at all," says Ted Schmelzle, assistant vice president of retirement plan services at The Standard.

From the plan participant perspective, higher fees for small plans take a larger bite out of savings, but experts say these fees remain small relative to the post-tax savings and potential future benefits of investing in the plan.

"You're talking about investment growth of multiple, full percentage points and fees that are basis points," says Sean Jordan, head of small- and mid-market segments at Principal Financial Group. "They're different scales."

Benefits Over Time

For participants, any employer match can further offset costs, and there are other benefits to encourage participants to save in a workplace plan, despite fees.

"There are things that participants can get from a plan, such as the possibility to take a loan or make a hardship withdrawal: That might not be available in an if that's the alternative," says Joe Valletta, the principal owner of HR Investment Consultants and co-author of the "401k Averages Book."

Another factor in favor of plan participation despite higher fees is that, as both the plan and participant assets grow over time, the cost of the plan should start to decline, especially in a PEP that is quickly expanding. So even if tax benefits do not pan out in the first year, those savings compound over time.

"Generally, as a plan gets bigger, the cost per participant will get lower," says Schmelzle. "The benefits to all of us, as individuals, of saving and starting early far outweigh the risk of not doing so, even if you compared it to a similarly situated non-tax-qualified vehicle like a brokerage account, where trying to invest those dollars are generally more expensive."

Tags	retirement plan fee benchmarking, retirement plan fees, SECURE 2.0 Act of 2022, Setting Every Community Up for Retirement Enhancement Act of 2019, small plans
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While many small employers understand the benefits of offering a retirement plan to their workers, more than 40% of these employers do not offer a plan—largely because they cannot afford it.

Employers also assume fiduciary liability when offering a retirement plan, which can be daunting and an extra burden on employers managing all aspects of their business. Automatic IRA programs developed by states and the SECURE 2.0 Act of 2022's new tax credit for small businesses have allowed employers with less than 100 workers to more easily offer access to retirement savings, but more work still needs to be done to fully close the access gap.

According to the Bureau of Labor Statistics, 57% of private sector firms with fewer than 100 workers offered a retirement plan as of 2023, whereas 86% of companies with 100 or more workers—and 91% of firms with 500 or more workers—offered a plan.

As of 2023, small businesses employ about 61.7 million Americans, making up 46.4% of private sector employees, according to the Small Business Administration.

State auto-IRA mandates now require private sector employers in 17 states to facilitate participation in a state-run plan, with many other states either preparing to implement or considering state-facilitated retirement programs. According to Georgetown University's Center for Retirement Initiatives, about 220,000 employers are currently registered in state IRA programs, and about 66,000 are submitting payroll deductions.

A recent paper by the National Bureau of Economic Research also found that the state mandates are prompting more small employers to offer private market retirement plans to their employees.

A Small Employer's Experience

Robb Hendrickson, co-founder of Green Paws Chicago, an in-home pet care service, facilitates use of the auto-IRA program Illinois Secure Choice for his 40 employees. Green Paws has been a participant of Illinois Secure Choice since 2019.

"We like the plan because it offers our employees a way to save directly out of their paychecks, " Hendrickson says. "It's a very low payroll burden in terms of the amount of additional time that it adds to our payroll [team]. … It's a pretty small imposition for us to give our employees a chance to save toward their retirement."

Hendrickson says many of his employees are either in their 20s or early 30s, and he believes it is important to encourage people to start saving early for retirement and not wait until later in life.

When new employees are hired at Green Paws, they are automatically enrolled into the Illinois Secure Choice program, as long as they do not manually opt out. Within the first 30 days of their employment, they can choose to opt out or change the percentage that will be deducted from their paycheck.

The default contribution rate is 5%, and it increases by one percentage point annually until it reaches 10%, Hendrickson explains. Participants can also go into their saver portal and change the asset allocation if they choose to. For example, they can set their savings plan based upon their projected retirement year or the year they were born, or they can choose to put their money into specific investment funds.

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Weighing the Options

[illegible]

Startup Tax Credits

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Eligible employers with 100 or fewer employees and with at least one participant who does not qualify as highly compensated are able to claim a tax credit of up to $5,000 for each of three years for the ordinary and necessary costs of starting a SEP, SIMPLE IRA or qualified plan, like a 401(k).

"Increasing the tax credits definitely seems to have had an impact on small employers being able to start up plans," Ulrich says. "When we talk to employers about starting a plan, and you let them know that they'll be able to get a tax credit for their administrative costs for the startup administration, it definitely allows them to create a plan for the employees where they wouldn't have been able to in the past because of tax cash flow issues they may have had."

At ADP, Ulrich says he has seen increased creation of new plans in recent years and attributes it to the new tax credits. He adds that the contribution credit, also created by SECURE 2.0, allows small employers to earn up to a $1,000 contribution credit for each employee that participates in the plan. Last year was the first year this credit became available, so Ulrich says it is still relatively new.

"We also think that's going to be a big impact, not only on small employers creating plans, but also [on] being able to make a contribution on behalf of their employees. That can be a safe harbor contribution," Ulrich says. "It will … really provide more contributions into plans from the employer side that many small employers may not be able to afford otherwise."

Tags	auto IRAs, PEPs, pooled employer plans, SECURE 2.0 Act of 2022, SIMPLE IRAs, small business retirement plans, state-run retirement plans
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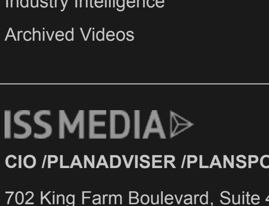

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