

FINANCIAL *fitness*

By RWM Wealth Advisor Sandy Carlson CFP®, CPA, CDFA™, QKA



The Self-Directed 401(k) Plan Option

Over the last several decades, employers have moved away from traditional defined benefit pension plans and adopted the defined contribution plan as the foundation for an employee's savings in retirement. This shift is due to the rising expense and long-term funding obligations which are paid from corporate earnings and thus have a direct impact on corporate profitability. Unlike the defined benefit pension plan, the funding obligation for a defined contribution plan is borne by the employee.

Within the defined contribution plan arena, 401(k) plans have emerged as the employer provided retirement plan of choice. A typical 401(k) plan offers a limited line up of mutual funds or target date funds as investment options within the plan. Mutual funds often carry high expense ratios (fees) and limit the ability to properly diversify across multiple asset classes. In response to the desire to have more investment options to choose from, as well as greater flexibility with their retirement savings, the "self-directed" 401(k) feature is gaining in popularity.

A self-directed plan is similar to a brokerage account. Rather than choosing 401(k) investments from a short menu of pre-approved mutual funds, participating employees have an entire universe of investments to consider. Therefore, the self-directed 401(k) offers a solution to the investment limitation by providing a "brokerage window" feature which allows investment of their 401(k) retirement savings among thousands of investment options available on the open market, including stocks, bonds, mutual funds and ETFs (exchange traded funds). A 401(k) plan must allow for this feature in the governing plan document and it must be available for all employees in the plan. If this feature is available, an employee can elect to manage their 401(k) savings individually or engage a professional investment manager.

If a professional investment manager is utilized, employees are provided with the assurance that a professional is managing their assets to achieve their overall retirement goals. Too often, the task of managing the investments is being handled by the individual account owner. These are individuals who have diligently saved into their 401(k) plan over the years, however they often lack the education and experience to manage what is usually their largest retirement asset. A sophisticated investment manager can assist with the investment selection and ongoing management and assure that the account is managed with the utmost care. It is important that all investments are being managed toward the same goals to achieve maximum efficiency. Unfortunately, most employees are negligent in the management of their 401(k) accounts. They rarely change their investment selections through-

out their working career or rebalance their account back towards their original asset allocation. The investments chosen ten years ago may no longer be appropriate given their current life situation, time horizon or risk profile.

A self-directed 401(k) can also reduce the internal expenses of the 401(k) account. Most employer selected mutual funds and target date funds tend to have high expense ratios, which directly reduce the overall return of the 401(k). Target date funds have been especially known to have higher expense ratios given their more frequent asset allocation shifts and structure. Through the ownership of individual stocks and bonds in your 401(k), you can potentially reduce the internal costs of the portfolio by a significant amount.

The self-directed 401(k) option is becoming a feature that is included in an increasing number of 401(k) plans and popularity has grown among partnerships such as law firms and medical practices. Large corporations have also been incorporating the self-directed option into their 401(k) plan. Today, over 30% of employers with more than 5,000 employees now offer the self-directed 401(k) option.

Sandy Carlson has over 20 years of wealth management experience including income taxation, retirement planning, executive compensation planning, insurance, banking, trust administration and estate planning. She is a Certified Divorce Financial Analyst™ (CDFA) and also holds the QKA designation by the American Society of Pension Professionals & Actuaries. She is President of the Financial Planning Association, a Tax Instructor in the CFP Program at Queens University, and is a member of the Charlotte Estate Planning Council. Sandy values getting to know her clients and providing creative, integrated solutions for accumulating, preserving and transferring wealth.



Where does your investment path lead?

Rinehart Wealth Management
Greater Trust

521 East Morehead Street / Suite 580
Charlotte, NC 28202
P: 980-585-3390 / F: 980-265-1274
RinehartWealthManagement.com
scarlson@rinehartwealthmanagement.com