401k Disadvantages

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Posted September 17, 2018

Many people want to contribute to an employer's 401k plan, and after careful consideration by your financial advisor it might be wise to do so. Some people also think about a 401k rollover into another 401k plan- this is when you leave ABC company and transfer your 401k into XYZ company's 401k. And this too might be a good idea. However, before you do this please consider some of the 401k disadvantages of employer-sponsored 401k plans.

Your Money Is Captive

Typically your 401k money is captive, meaning that you cannot take it or use it an another investment unless you qualify for a hardship exception. Some 401k hardships include medical expenses, higher education expenses, purchase of primary home, foreclosure prevention and a few others. In most hardship withdrawals you will incur a 10% tax penalty plus pay income taxes on the tax-deferred portions of the withdrawal. However, we have seen some 401k plans be amended to allow for a withdrawal for a primary residence purchase without the 401k penalty (rare).

Your money is also captive from the sense of investment choices. From decisions made on golf courses and boardrooms, you are only allowed to invest into funds or stocks that your employer graciously offers you and your colleagues. Unlike an IRA that can buy a rental property or an unlimited choice of equities and bonds, captivity is one of several 401k disadvantages. This means that your financial advisor or planner might not be able to fully help you reach your retirement objectives.

401k Fees

The average 401k plan for small employers is about 1.5% and for larger plans the average cost is 1.0% Not terrible. But you can probably pay less fees with a typical IRA, have more choices AND get financial planning advice. Fees are insidious.

Financial Planning

In many cases your financial advisor cannot make recommendations or assist you with your 401k investments. Because of certain fiduciary, monitoring and transparency rules, several brokers restrict financial advisors from directing an investment outside their domain. If your 401k plan is administered or “hosted” by a large investment firm such as Wells Fargo or some other name brand firm, you can get advice from a call center on your 401k investments. But now you are working with two or more financial advisors, and commonly the large firm with the call center is not going to fully be your advocate. Be careful.