Student’s Name

Instructor

Course

Date

401(k) Retirement System

# Why is there a market failure in the 401(k) market?

The major market indication of 401(k) market failure is the declining median amount in a 401(k) savings account. Based on an evaluation done by Employee Benefit Research Institute, approximately 40% of employees have less than $10,000 in their 401(k) savings account. Also, another factor contributing to this market failure is that the 401(k) system does not cover all employees. More than 35% of employees lack access to a 401(k) plan and even employees with this option resolve to contribute negligible amounts and not to participate at all (Holland).

As indicated by current market researches and surveys, most Americans, both employers and employees do not have a clue about the fees associated with their 401(k)s and the market dynamics which impact their retirement plans. Insufficient knowledge by employers is factor associated to the market failure. Bosses give 401(k)s onto their employees since they trust that providing retirement plans help them pull in and uphold specialized workers. Conversely, since workers have a small amount of motivation to guarantee that they give their representatives the finest plan of retirement, they search for reducing their expenditure with regards to giving out those advantages using many techniques (Holland). When secretaries shop for retirement plans, they normally provide workers with countless editions of similar plan, editions with equivalent investment alternatives but lower or higher cost rates for such options based upon what amount employers wish to forfeit, annually, to secretariats in favor of plan management. Bosses are more and more selecting plans that have small or zero employer expenses but elevated expense proportions, relaying the expenses towards their workers (Hilton 10).

Scarcity of knowledge by employees is another reason for 401 (k)s market failures. The majority employees who take part in 401(k)s plan have very little know-how about the charges related to their plan of retirement (Hilton 9). Practically, savers often choose imprudently: most 401(k) entrepreneurs trust that huge fees bring higher profits, when indeed the reverse is factual fee index investments typically have huger net profits than elevated-fee dynamically controlled ones. Such absence of information about the charges of retirements plan hurt them diversely, too: it permits other competitors in 401(k) framework to relay the expenses of this towards employees, making them have massive debts.

# Describe and detail all of the fees/costs associated with a 401(k).

401(k) system is associated with numerous costs. As indicated by Robert Hilton’s findings, 65% accountholders of 401 (k) were not aware that they paid a fee, and also 83%, had no primary know-how regarding the numerous fees and costs that everybody in 401(k) incurs (4). 401(k) program costs and expenses in general are classified into four groups: The first lot includes administrative costs (Hilton 4). According to Hilton, these are fund costs for recordkeeping, providing reports, transaction processing, guaranteeing the program adheres to applicable laws, resolving savers’ issues, and offering support services. Administrative costs usually vary from 20% to 40% per year. The second group includes management costs (Hilton 4).These are wages for fund supervisors, investment scientists, and workers in charge of fund’s projects. Asset administration costs typically vary from 50% to 100 yearly. The third group incorporates marketing costs (Gaviria & Martin Web). Such expenses comprise costs of educating investors and prospective investors concerning the investment including brochures, ads, and extra educational material (Hilton 4). Finally, we have trading costs which are expenses that the fund pays when purchasing and vending the bonds that consist of mutual funds’ underlying resources (Hilton 4).

# Yearly Savings: $15,000, Inflation Rate: 2%, Rate of Return:(8.15%-.15%=8%), Expense Ratio of Mutual Fund: .15%, Periods: 30 years

Total amount of Retirement assets= $p[\frac{(1+r)^{n }-(1+g)^{n}}{r-g}]$

P= yearly savings

R= rate of return

G = inflation rate

N= number of periods

$$15000[\frac{(1+0.08)^{30 }-(1+0.02)^{30}}{0.08-0.02}]$$

= $2,062,824

The calculation indicates the total amount of retirement assets after 30 years. The calculation indicates that the investment total that this individual will get after 30 years of investing into the mutual fund is $2,062,824. The fees charged included an Expense Ratio of Mutual Fund which is somehow low. The inflation rate of 2 percent is used as a discounting factor to ensure that inflation does not consume the retirement savings faster. This means that the person will receive substantial investment after 30 years because lower fees have a small impact on the investment totals (Gustafson).

## Yearly Savings: $15,000, Inflation Rate: 2%, Rate of Return: (8.15%-.65%=7.50%) (It is lower than example (a) due to the increased expense ratio), Expense Ratio of Mutual Fund: 65%, Periods: 30 years

Total amount of Retirement assets= $p[\frac{(1+r)^{n }-(1+g)^{n}}{r-g}]$

P= yearly savings

R= rate of return

G = inflation rate

N= number of periods

$$15000[\frac{(1+0.075)^{30 }-(1+0.02)^{30}}{0.075-0.02}]$$

= $1,893,707

 As indicated above the total investment which this person will receive after 30 years of investing in the mutual fund is $1,893,707. The fees charged included inflation rate of 2 percent and mutual fund of .65%, which is more than the earlier one. The impact of this increased fee is seen in the total investment received of $1,893,707which is lower compared to $2,062,824 received at .15% Expense Ratio of Mutual Fund. This means that when the expense ratio is higher, the final investment to be received is negatively reduced and an individual receives a small amount of the investment after 30 years and vice versa (VanDerhei 17).

# Describe and come up with your own solution to alleviate the problems with 401(k)s.

The weaknesses of 401(k)s can be fixed by introducing a fiduciary standard which applies to all professions and also regulators and legislators need to impose laws for protecting American investors. One way involves improving fiduciary principles of 401 (k) plans, counting cost, options for investment, transparency/integrity along with conflict prevention. By having a fiduciary standard aimed at commoditizing the 401(k) funds and de-linking them from employers will ensure the 401(k) is an open program which is open to anyone whether employed or not and hence diversifying index funds at the lowest possible prices.

Works cited

Finance Formula. "Future Value of Growing Annuity." *Financial Formulas (with Calculators)*, www.financeformulas.net/Future-Value-of-Growing-Annuity.html.

Gaviria, Marcela, and Martin Smith. "The Retirement Gamble". *FRONTLINE*, 2013, http://www.pbs.org/wgbh/frontline/film/retirement-gamble/.

Gustafson, Bob. "Inflation Impact on Retirement Planning, Retirement Savings." *Triton Financial Group*, 10 Feb. 2018, tritonfinancialgroup.com/inflation-impact-on-retirement-planning/.

Hilton, Robert. *The retirement savings drain: The hidden & excessive costs of 401(k)s*, n.d, pp.2-15. *Demos.org*. http://www.demos.org/sites/default/files/publications/TheRetirementSavingsDrain-Demos\_0.pdf

Holland, Kelley. "For Millions, 401(k) Plans Have Fallen Short." *CNBC*, 24 Mar. 2015, www.cnbc.com/2015/03/20/l-it-the-401k-is-a-failure.html.

VanDerhei, Jack. "Retirement Savings Shortfalls". *The Journal Of Retirement*, 2015, *Institutional Investor Journals*, doi:10.3905/jor.2015.2015.1.020.