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Take full advantage of employer retirement plans but also look at options like IRAs

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Employer-sponsored retirement plans like 401(k)s and 403(b)s have come a long way over the past several years. Most now offer investment options that could be used to build a solid core for a long-term strategy. But there are several reasons that you might want to use investment accounts outside of your employer plan to save for retirement.

This is particularly the case for employees of small companies whose retirement savings plans tend to include higher investment management and administrative fees.

Outside the employer account, it might be helpful to own an Individual Retirement Account (IRA), either of the traditional tax-deductible variety or the tax-free Roth IRA. IRAs have lower annual contribution limits – $6,500 for people under 50, $7,500 when over 50 – than employer accounts. There are also eligibility limits based on income that prevent high earners from gaining tax benefits from IRAs. However, they could help fill vacancies left by undesirable or limited investment selection of an employer retirement account.

Here are some ways that an IRA can be complementary to a 401(k) or other type of employer plan:

▪ **Extend diversification:** Most employer retirement plans, whether they have 10 investment fund choices or 30, stick to primary asset classes and tend to provide many more stock market funds than bond funds. Investing in an IRA provides access to many other investment types, like Treasury Inflation-Protected Securities, foreign bonds, emerging markets stocks or Real Estate Investment Trusts (REITs). Including some of these choices in your portfolio can improve global diversification and possibly boost investment returns.

▪ **Implement specific ideas**: In addition to seeking broad diversification, an investor might want to emphasize a particular idea. It might be desired to own an individual company stock or to invest in a certain theme like a renewable energy fund or one that emphasizes companies that have grown their dividend payments consistently.

- **Sustainable or socially responsible investing:** Expanding on the idea of an investment theme, many retirement plans have begun to offer choices in this area, but those that do tend to offer just two or three choices. There is rarely a robust enough set of investments to create a fully balanced investment portfolio. If you wish to express a values-based preference for the types of companies you invest in, you have far more flexibility for how to do it an IRA.

- **Inexpensive index funds:** Many employer retirement plans do include passively managed index fund options. Theoretically, these should be used to gain broad market coverage at the lowest possible cost. Especially in small retirement plans with fewer participants and less money invested, these index funds can have management fees that far exceed options available in the retail marketplace using an IRA.

  For instance, Principal Financial is an administrator of many employer retirement accounts. The Principal Large Cap S&P 500 Index R1 share class (ticker PIPLX) for medium-sized companies has a management fee of 1.03 percent of the fund balance per year. For every $10,000 invested, $103 goes to pay the fund company. Alternatively, in an IRA you could purchase access to the same market index through the iShares Core S&P 500 Index exchange-traded fund (IVV) for a management fee of 0.03 percent ($3 per $10,000 invested). Using a more cost-effective fund to keep an extra 1 percent of investment return annually, without changing your investment strategy, would make a large difference over time. You could then focus your employer plan investments on available funds that might provide more value compared to their cost.

In considering how to balance the use of a 401(k) and an IRA, you'll first need to determine what percentage of your income to defer each paycheck to your employer plan. Generally, you should participate in your employer plan at least to the level at which you obtain any available employer matching contribution. After that point, you could decide about the use of an IRA where you have more control over investment selection. Income eligibility for the IRA depends on whether you're contributing to a traditional or Roth IRA and whether you are a single or married taxpayer. If you are eligible and you reach the IRA contribution limit each year, then you could go back to contributing to the employer plan or open a non-retirement brokerage account that has no contribution limits or income limits.

Of course, if you've moved on to a new job or retired, you do not need to leave your money in your former employer's retirement plan. You can take control of your investment choices and their costs by rolling them over to an IRA, following rules to ensure that the account's tax-deferred benefits continue.

While there are many decisions to evaluate, the benefits of perhaps lowering your costs and increasing the quality of your investment options could be lucrative over time.

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