Using Investment Education to Enhance Profitability: Where Have Plan Providers Gone Astray?

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Published in
Employee Benefits Journal
December 2001, Volume 26, Number 4
International Foundation of
Employee Benefits

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In today's 401(k) marketplace, the intelligent use of technology, coupled with well-thought-out modifications of traditional approaches to sales and participant communication/education, is the key to maximizing profitability.

Where we are today

Today's 401(k) marketplace is brutal. Among large and medium size companies, the market for new plans has dried up. New business comes from sponsors who are dissatisfied with their current providers or existing clients acquiring other companies. Furthermore, plan sponsors view recordkeeping and investment options as commodities. Thus, participant education and communications (and the technology used to deliver it) have become the primary way in which a provider can positively differentiate itself from the competition.

In fact, increasing numbers of providers are supplying plan sponsors with sophisticated Web sites. These Web sites permit sponsors to access plan data and create reports of what they want when they want it. This report generating capability greatly enhances the ability of sponsors to monitor on a timely basis the plan and its investment options.

Sufficient attention, however, has not been paid to the needs of participants. Yes, participants can now monitor their accounts and make transactions over the Internet. Calculators and articles on investment topics abound on providers' Web sites. Links are provided to other Web sites that the provider believes may be of interest to participants.

Indeed, many providers can now unequivocally say that they have a participant Web site. To say that that the site is educational, however, is a big mistake. In fact, because these sites are not educational is probably one of the reasons why so many of them are seldom used.

How did we get here?

In the 401(k) marketplace, providers, whether they are banks, mutual fund companies, or insurers, have been driven by three goals:

1. gathering more assets, either from new clients or by increasing contributions from existing ones;
2. obtaining a larger share of the IRA rollover market;
3. minimizing all expenses, including development, implementation, and ongoing.

Thanks to the Department of Labor's scrutiny of fees paid by participants, now a fourth goal has emerged:

4. providing participants more "bang," more value, for their buck.

A well designed Web site can be a very powerful tool for accomplishing all four of these goals. Unfortunately, however, the implementation of this technology has been plagued by the fragmented approach most providers have taken. Rather than asking: "What goals are we, as a corporation, trying to accomplish?", marketing goes in one direction, sales in another, education/communications in a third, etc.

To make matters worse, as technologies evolve, such as the transition from PC to LAN to Web site, there is a tendency not to integrate into the new what was good in the old. In fact, the designer's enthusiasm for new technology, rather than for what is effective, often dictates the content and format used. The net result of this "helter skelter" approach is an agglomeration of software and other tools that are not unified and are therefore not an effective asset gathering tool.

Participant Web sites have been developed primarily for two reasons, cost savings and image. Web sites enable providers to reduce their printing and mailing costs. There is also a reduced need to keep an inventory of printed materials and run the risk that they will become outdated since participants can easily download whatever they want.

Participant Web sites also reduce the costs of servicing participants. It is far less expensive for a provider to have participants get their questions answered by going to a Web site than by calling a customer service rep or even using a voice response system.

Providers have also developed participant Web sites so they would have better answers to request-for-proposal questions on participant education. Often a sponsor's representatives don't even look at the Web site. If they do, as long as the site looks more or less like the competition's, the provider's goal has been accomplished. The copycat syndrome, sad to say, is very widespread among the provider community.

The concept that investment education could be an asset gathering tool has never entered the business plans of providers. After all, the conventional wisdom has been that participants do not want to be educated. Maybe this attitude can help explain why only 19% of rollover IRAs go to the participants' former 401(k) provider.[1]

What Went Wrong

The United States has a negative savings rate. Although the causes of this problem are many, three stand out:

1. Plan providers have done little to catch the attention of participants and make clear the magnitude of their retirement challenges.
2. Vendors have failed to give participants the tools they need to understand investing and make informed choices.
3. Providers did not differentiate asset gathering expenses from educational expenses that should be paid by plans and/or participants.

Plan sponsors and providers are just beginning to accept the fact that personalized statements showing participants where they are along the road to retirement and their accounts' overall rate of return have an impact on participant attitudes. Somehow providers forgot that people will not address problems if they:

1. don't understand their real significance;
2. view them as too far in the future to worry about,
3. don't know how to approach them.

To make matters worse, plan sponsors and providers do not want to own up to the following facts of life.

1. True investment education on company time is not realistic because of its cost, time requirements, and scarcity of instructors.

[1] Jacobius, Arleen "Good times may be over for 401(k)s" *Pensions and Investments* April 30, 2001.

2. Participants must be told that if they are going to have financial security during retirement, they are going to have to become involved, and this requires a time commitment.
3. Web-based advice does not provide the handholding, encouragement, or empathy uninformed investors need to stick with recommendations whose conceptual basis they don't understand.
4. Advice services, including the Web-based ones that 401(k) plans use, are being offered because a problem exists—participants do not know how to do their own asset allocations—and not because there is evidence that shows they provide significant value to participants.

Ironically, in spite of the fact that everyone knows that the current approach to investment education has been an abysmal failure, no one wants to change what is being done. The same enrollment meetings take place, the same materials get passed out, but only now they also end-up on the provider's Web site.

Rethinking What You Are Doing

In *Alice and Wonderland*, Alice asked the Mad Hatter which way she should go. The Mad Hatter promptly asked Alice where she was heading. Alice said she had no particular place in mind. If that's the case, the Mad Hatter replied, then it makes no difference which way you go.

Like Alice, many, perhaps even the vast majority of, 401(k) marketing and sales organizations have never clearly defined their destinations. Furthermore, to win in the 401(k) business it is imperative to set goals at the corporate level rather than at the individual department level. In most companies, however, this also is not done.

For example, getting new 401(k) clients and then servicing them falls under the bailiwick of the 401(k) group. Capturing rollover business is usually the responsibility of retail brokerage. Since retail brokerage and the 401(k) group seldom talk, let alone refer clients to each other, it should be no surprise that when participants terminate their jobs, they seldom select their former 401(k) service providers for their rollover accounts.

If most of the growth of 401(k) assets over the past five years had resulted primarily from net contributions, the lack of coordinated asset gathering and retention strategies could conceivably be tolerated by providers. When 80%[2] of the growth of assets is due to market appreciation, however, this dysfunctional organizational behavior can easily turn into a fatal mistake for providers.

If, on the other hand, the various groups within a single company are willing to work together, perhaps even create a learning organization, the intelligent coupling of technology with investment education can create sales opportunities never before thought achievable.

What is in the best interest of providers, then, is also in the best interest of sponsors and participants. The latter two groups can't get real value for their fees until providers get their acts together.

A new integrated system for maximizing profitability for the provider while enhancing value for sponsors and participants

The first step in creating a win-win process is making participants aware of their retirement needs. The sad fact is that many participants haven't even tried to determine these needs. Of those who have tried, many have not done the analysis carefully or rigorously. It is imperative, then, that the provider produce a statement that can be handed out or mailed to each participant showing where he

[2] Jacobius, Arleen "Good times may be over for 401(k)s" *Pensions and Investments* April 30, 2001.

or she is along the road to retirement and what the participant has to do to stay or get back on track toward a secure retirement.

Providers, however, like to create statements that show the power of compounding. If a participant invests “$X” out of each paycheck, and the account grows at various growth rates, “$Y” will be there in 20 or 30 years.

Unfortunately, participants who are earning $30,000 and have $15,000 in their 401(k) accounts have trouble comprehending a several hundred thousand dollar next egg. To make matters worse, these statements give no indication which, if any, of the anticipated nest eggs are adequate for the participants’ needs. The commonly used statements showing the power of compounding, then, have little value when it comes to helping participants define and achieve their goals.

The biggest obstacle to creating a “where you are along the road to retirement” statement is that recordkeepers often do not gather all the data needed to produce these statements. Missing data commonly includes salaries and deferral percentages. This lack of data that also contributes to the inability of many providers to effectively data mine their records.

Once participants get their personalized “where you are along the road to retirement” statements, they often want to change the assumptions that are incorporated into the statements, such as anticipated retirement date, replacement ratio, and Social Security benefit.

Thus the next step in creating the win-win process is allowing participants to go to the provider’s Web site and ask “what-if.” If the input screen is designed simply, if the software is pre-populated with employee data, and if the output has the same format as the original hardcopy, the “what-if” process will help participants realistically asses their goals and reevaluate their payroll deduction amounts.

The third step in the new system is the creation of common interfaces for the software that is used during enrollment meetings, counseling sessions, and workshops, and that runs on PCs, kiosks, and Web sites. This is a very important step because it enables participants to become familiar with the software even before they sit down with a computer. In fact, during these meetings the provider’s communicators can show participants how to use the software.

Step three, then, not only demystifies the software for many participants but also shows them how easy it is to use and the questions that it can help answer. The power of this step is that it shows participants just how easy it is to help themselves.

The next step is to provide participants tools beyond calculators for determining retirement income or funding college expenses. Plan providers and sponsors must recognize that a large portion of learning comes from hands-on experience.

For example, a participant can learn only a limited amount about the volatility of portfolios by looking at prepared bar charts or tables. These figures show that returns bounce around, and that volatility is related to the portfolio’s composition. A participant can only truly understand portfolio volatility, however, if she can construct portfolios herself, change their composition, and compare performance in whatever time periods she likes. In fact, the participant should be able to construct portfolios using her own available investment options or proxies for them.

Software tools can also help participants, among other things, differentiate and explore the various types of risks they face. Participants can also use software to learn just how successful various portfolios have been in generating specified income streams under various economic conditions.

The next step in creating an integrated system is the development of online resources. These materials must not only provide a solid background so that participants can get the most out of the calculators and modeling software, but they must also combat the misinformation and hype that pollute the financial press.

Providers and sponsors have simply ignored the fact that participants read publications like *USA Today* and *Money*. What participants read in these and other popular publications and what they see on TV will have considerable influence on how participants will value their 401(k) plans, view their providers, judge their sponsors' concerns for the success of the 401(k) plan, and determine which vendor will get their rollover IRA.

Four-page quarterly newsletters just don't fill the bill unless their roll is simply to introduce topics and then refer participants to other readily available resources. What is often forgotten, however, is that these resources should be on the provider's own Web site. Links to other Web sites simply tell participants that their provider doesn't have all the resources they need.

The provider's Web site must become a destination site for participants and sponsors alike. Web site content must discuss current market activity, the reasons underlying the performance of their investment options, the practical applications, including examples, of asset allocation and current topics in behavioral finance.

Behavioral finance is an important topic because it helps participants understand how they react to money and investing. This understanding can help them get control of their emotions and respond more rationally to risk tolerance questionnaires.

It's not hard to imagine class action lawyers arguing that a provider's communications materials were too incomplete to be accurate and thus caused participants to give uninformed answers on the provider's risk tolerance questionnaires. The lawyers would conclude that these uninformed answers led to inappropriate asset allocation recommendations and ultimately inadequate retirement nest eggs.

Providers must also recognize that they have an obligation to participants and sponsors to explain, clearly and fully, the limitations of the advisory services the provider has endorsed. Participants must be told that it is unrealistic to hope that these gurus can predict how the capital markets are going to behave in the future.

Participants must also realize that all a good advisor can do is to help them get their "act" together. Unfortunately all too many participants don't want a process that involves their participation. The attitude of these participants can be summarized by paraphrasing an American Express TV commercial, "We know you have a life to lead and investing is not part of that busy life."

Making available easy to use modeling software and encouraging and showing participants how to use it will help participants understand the advisor's recommendations and the limitations of the advisory process itself. The likelihood that the advisor and sponsor will be sued successfully by participants when anticipated nest eggs don't materialize will also be decreased.

Neither providers nor sponsors should forget that there is simply no evidence to suggest that any of the advisory services will have significant long-term value for participants. If anyone thinks that this latter statement is too harsh, they should ask themselves what is the value of most research that comes out of Wall Street. *Fortune*, on the front cover of its May 21, 2001 issue asked, "Can we ever trust Wall Street again?"

If the Web site provides participants with a pleasant and satisfying educational experience, if it becomes a valuable resource tool, and if the participant considers the site as a favorite Internet destination, the provider is on the way to accomplishing still another one of its goals, cost reductions. If participants frequent the provider's Web site routinely, the need for print materials and their distribution costs will decrease dramatically. The savings which will be achieved can then go to either increasing the bottom line or being reinvested to create more asset gathering tools. In either case, the quality of the investment education will benefit the provider, sponsor, and participant alike.