

Investment Education: Who's Fooling Whom?

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As the baby boomers start to retire, all too many of them will realize that their retirement nest eggs will be insufficient to maintain their current standard of living. Benefit experts anticipate that many of the boomers will try to make up their shortfalls by suing their former employers (plan sponsors) and the vendors who serviced their self-directed retirement plans. There is also concern that the Department of Labor (DOL) will also join in these suits on behalf of the participants.

Perhaps the thrust behind these law suits will be: (1) Plan sponsors and vendors played down the facts that achieving retirement security is the participant's responsibility and obtaining this goal requires work on his or her part. And (2) plan sponsors and their vendors distributed to participants misleading, incomplete, and hence inaccurate investment education materials.

The threat of participant law suits should surprise no one. Few plan sponsors and vendors, based upon their materials, appear to have asked questions such as the following:

1. What are the goals of our educational program?
2. Have we made it clear to our employees what their responsibilities are?
3. Do our materials imply that just participation in the plan and getting an employer contribution will create an adequate retirement nest egg?
4. Do our materials convey the messages they should or are our vendors giving our participants brochures designed for retail investors?
5. If current investment education programs are as effective as vendors claim they are, how do we explain the results of the Fifth Defined Contribution Plan Survey conducted for The John Hancock by the Gallup Organization in 1997? For example, it found that 47% of 401(k) plan participants believe that stocks are components of money market funds. 55% of those surveyed thought they couldn't lose money in government bond funds. In fact, the same survey demonstrated that 401(k) participants have gained little knowledge about investing over the last five years. These findings are even more surprising in light of the respondent demographics (Table 1). As you can see, they didn't survey high school dropouts.

Table 1: Survey Respondent Demographics

Average Age	40
Average Annual	\$51,540
Average Account	\$42,030
College Graduates	50%

Source: *The Fifth Defined Contribution Plan Survey: Insight Into Participant Investment Knowledge and Behavior.*
John Hancock Financial Services.

6. How do we also explain the results of the 1997 Retirement Confidence Survey coorganized by the Employee Benefit Research Institute, the American Savings Education Council, and Mathew Greenwald & Associates, Inc? They found that less than a third of American workers have ever tried to calculate how much money they will need to retire comfortably.

Investment Education: Who's Fooling Whom?

7. If the following observation is correct, how comfortable should we be in offering prepackaged portfolios, asset allocation services, and twenty minute counseling sessions to our employees?

“Trash collectors and other non-professional types would give professional forecasters in most disciplines a run for their money...if there is one bright spot for Wall Street market analysts, it's that economists have an even worse record when it comes to forecasting.”¹

8. What percent of our educational program is paid for by participants, either directly or indirectly through the investment options' expense charges?

These seldom asked and rarely answered questions are just a few of the reasons why large, well-informed plan sponsors are concerned that they may be sued by participants in the future.

This paper reviews why investment education has failed; explores the investment education process; and asks how much investment education can be realistically provided by employers. Lastly, Just-in-Time education—the training methodology that will likely become the most dynamic and widely used approach to investment education—will be discussed.

Why investment education has failed

Investment education isn't working for many reasons, but perhaps the most important ones are:

1. What vendors and plan sponsors call investment education isn't investment education at all. Vendors have been passing off hour-long enrollment meetings as meaningful educational experiences. Short, glitzy pamphlets that say essentially nothing are touted as leading-edge adult education materials. Vendors brag that clients love their stuff and anoint their approaches as “best practices.” The objective surveys mentioned earlier demonstrate that being liked and being effective and beneficial are quite different things.
2. Workshops and written materials are created in a “one-size-fits-all” manner, and they are targeted at the lowest common denominator of employee intellect. The net result of this is that most materials are too elementary for perhaps as many as 80% of the participants.
3. All too often plan sponsors do not bluntly tell their employees that they must assume responsibility for their own retirement security. Employees simply don't comprehend the magnitude of the retirement challenges they face.
4. To effectively assume responsibility for their retirement security, participants must run their accounts as if they are managing a defined benefit pension plan. This requires knowledge. And, educationally speaking, most participants can't even get to first base. And why should they? If trustees hire consultants year in and year out to do asset allocation studies, perform manager searches, and to educate themselves, what can we realistically expect from the average participant who is offered just one or two hour long group sessions annually?
5. Investment education programs are often left to communicators who know little about investing.
6. The argument that investment education would be construed as giving investment advice, with participant law suits resulting, gave credence to the belief that it was prudent not to offer investment education.
7. This fallacious argument masked the need for both vendors and plan sponsors to address key issues, including:

¹ “Future Schlock”, *Institutional Investor*, March 1998, p.200.

Investment Education: Who's Fooling Whom?

- the price employers will have to pay if their workforces can't afford to retire;
- the likelihood that both the DOL and the financial press would inquire about the benefits participants get for all the fees they are charged;
- who—the plan sponsor, vendor, or participants—should bear the cost of developing the appropriate investment education materials;
- how should the investment education process be structured and delivered?

These are the main reasons why investment education isn't working. Should fiduciaries of public funds care?

Public plans

Although public funds don't fall under ERISA, ERISA is still probably the best source for determining the obligations of fiduciaries of public funds. (See Richard D. Glass and Robert A. Johnson, "Educating participants on investment: Is the myopic legal tail wagging the dog?" Plan Sponsor, February 1997, p.78.) To begin with, ERISA does not require employers to provide investment education. However, one of the requirements for section 404(c) compliance is that complete and accurate information be distributed to participants. Unfortunately no one knows what that means. For example, is describing a fund's risk solely in terms of its annual volatility complete and accurate? Perhaps inflation-adjusted returns should also be shown?

ERISA states that plan sponsors must act in the best interest of plan participants. Does that mean that if a plan sponsor knows that large number of participants can't make intelligent asset allocation decisions, the fiduciaries must provide a selection of prepackaged, professionally managed portfolios based upon anticipated retirement dates?

Perhaps the courts might even conclude that fiduciaries have an obligation to continually remind participants of the importance of monitoring their retirement plan investments and assumptions.

Another way for fiduciaries to get into trouble is to misinterpret surveys that supposedly measure the effectiveness of educational programs. It is easy to measure the effectiveness of a program that is aimed at increasing, in the near term, participation and contribution levels. It is not easy, however, to measure the success of programs designed to get employees to invest more in stocks.

After seeing the performance over the last ten years of both the equity and the fixed-income markets, it is easy for participants to conclude that they missed the band wagon by being invested in so-called conservative investments. In fact, many may conclude they were jerks for being scared of equities. If participants move into stocks now, perhaps buying at a market high, can it be said that a vendor educated them? Perhaps it would be more correct to say that they were persuaded. The answer will be known once the next bear market comes.

In addition, don't forget that fiduciaries also have responsibilities for seeing that plan participants get the best value for the fees they pay. Good luck in defining what best value means.

In short, fiduciaries must know what they are doing.

The investment education process

Now let's delve into the investment education process. The first step in the educational process is to get informed participation. Informed participation means that participants:

1. know why they are in the plan;
2. know what their retirement income needs are;

Investment Education: Who's Fooling Whom?

3. have a strategy for achieving financial security during retirement;
4. understand and accept that, when it comes to investing, there are no guarantees.

So how do you get informed participation? Informed participation is obtained by hitting participants over the head. Give each of them a customized report that:

1. realistically appraises his or her retirement prospects;
2. emphasizes that retirement planning is the responsibility of participants and requires work on their part.

Customized reports are much better than the worksheets that are routinely distributed to participants? Short reports will be read while worksheets won't be completed. Employees feel it is not worth the time to complete them.

Personalized reports give employees a chance to quickly and easily rethink the issue. Reports will also help protect employers from future lawsuits by participants. Employees will not be able to say that they were not made aware of their retirement income needs or that saving for retirement was not their responsibility. They will be unable to argue that the plan sponsor or the vendor misled them.

This protection is very important because vendors love to hype whatever they are peddling. All too often, at least in the 401(k) marketplace, the impression is given that self-directed plans are self-completing. Just contribute, you'll get that generous employer match, and everything will work out fine. Such sales spiels are misleading and will only generate problems for all concerned.

Let's review one such customized report (Chart 2). Note the question and answer format. It tells a story. As you can see, it is not the normal transactional or number oriented report that is routinely passed out.

The first thing participants are given is a goal—a replacement ratio of 75% of pre-retirement income adjusted annually for inflation. The inflation-adjusted numbers usually “knock the socks off them.” Then the assumptions that are utilized are reviewed. In fact, participants are told that assumptions often don't materialize and that it is imperative to periodically review them.

Then they are shown how required contributions vary by assumed growth rates and the asset allocations that have historically generated these returns over long time periods. Anyone who reads one of these reports will know that investing for retirement requires a well thought-out and executed game plan.

So what's the next step in the education process? Before answering, remember that participants have to allocate their money today, before they take Investments 101. Is the next step a discussion of stocks and bonds, the characteristics of asset classes, the investment options, or understanding a prospectus?

Perhaps it is the prospectus. After all, the prospectus is suppose to guide participants in making good decisions? It should clearly outline what the fund manager will be doing and lay out the fund's risks? However, everyone knows that it doesn't do this.

Perhaps we can skip most of the above and jump right into portfolios. It's portfolio construction and the underlying asset allocation process that presents the greatest challenges to participants. After all, it's the performance and risk characteristics of the portfolio, and not that of any given fund, that counts. In spite of this, few vendors report overall account performance.

Investment Education: Who's Fooling Whom?

Maybe I have “jumped the gun.” Shouldn't the different types of risks be addressed first? After all, the various risks affect each participant differently. For example, younger participants should concentrate on getting an inflation-adjusted return and not worry much about annual volatility. Older participants must be concerned about volatility for if their account suffers a big loss, the level of their retirement income may drop precipitously.

How do your brochures rank the risks of each fund—by their anticipated ability to keep up with inflation or by their historical annual volatility? It's by volatility, of course. Is that approach complete and accurate? For example, money market funds are safer than stock funds from the perspective of volatility. However, money market funds historically are much riskier than stock funds if your goal is to maximize your ability to outpace inflation. What message do you want to deliver to participants?

Remember, plan fiduciaries are responsible for the materials vendors pass-out.

Little if any material about most individual funds is prepared specifically for the self-directed retirement plan market. Prospectuses are written to protect fund companies, not to enlighten participants. Brochures about individual funds are sales pieces whose purpose is to persuade, not to educate. Buy is their message. Raising doubts about the wisdom of the purchase is definitely not their goal.

How much investment education can employers provide

By now, you might be thinking:

1. This stuff is overwhelming. Who has the time and money to offer an educational program that is comprehensive?
2. Do we have a fiduciary obligation to provide a comprehensive program?
3. If we don't, what are we obligated to provide?
4. If we pull employees off the job to educate them, is this going to destroy their productivity and morale?
5. How do we educate a workforce that is spread out all over the place.
6. Where can we find qualified people to deliver the program?
7. How do we get employees to assume responsibility for educating themselves?
8. Are our employees capable of understanding investing and developing realistic expectations for the capital markets?
9. If our employees aren't capable of creating and monitoring appropriate portfolios, how do we help them?

These questions zero in on the real issues that surround investment education. It's apparent that what is being done today isn't working. Furthermore, plan sponsors cannot afford to establish traditional classroom investment education. It is simply too expensive, too time consuming, and too disruptive to the workplace environment.

Plan sponsors must stop trying to please workers by telling them what they want to hear or by saying nothing. Rather, plan sponsors must start telling employees what they have to know and understand whether or not they like the messages.

Plan sponsors must recognize that they can't force employees to help themselves. Remember, “You can take a horse to water, but you can't make him drink.” All plan sponsors can realistically do is to help employees help themselves. Plan sponsors have a fiduciary obligation to stop wasting good money—theirs and the participants—on ineffective approaches.

Investment Education: Who's Fooling Whom?

So what is a realistic and cost-effective alternative to traditional classroom education and the pseudo-education that is going on today? It is Just-in-Time education. This training methodology is being used successfully nationwide to train people at all levels and in all types of fields. It incorporates technology-enhanced learning, and it is much less expensive to develop and implement than traditional classroom education.

In fact, the 1997 National HRD Executive Survey found that by the year 2000 almost half of all training will be done via some form of electronic technology. In fact, instructor-led training will decline from 80% to just 55%.

Just-in-Time education

Some of the tenants of Just-in-Time education are:

1. People don't remember material unless they think it is relevant to their needs or they find the subject interesting. And even then, what they recall is often minimal.
2. People often need only select bits of knowledge at any given time to do specific tasks. An individual doesn't have to master a topic completely to do a specific task well.
3. Cognitive psychologists have found that employees learn better when they can pick the time and place to study as well as the pace of learning. People must be receptive to learning. If their mind is elsewhere, it is a waste of time to try to educate them. In Just-in-Time education, participants are supplied the tools they need to learn about a given topic. Then, the participant can use the tools when and where they find most convenient, be it at home, on the job, on an airplane, or in a hotel room.
4. Technology-enhanced learning can insure the quality of instruction and the customization of course content. It is also a highly effective means of providing to a scattered workforce updates and course revisions in a timely fashion.
5. Technology-enhanced learning provides the opportunity for hands-on experience under the guidance of an expert. Cognitive psychologists have demonstrated that people must be able to practice skills in order to cultivate, retain, and improve upon them. The asset allocation and portfolio construction processes are prime examples of the need for hands-on experience. Only through working with actual data will participants develop confidence and learn how to cope with the uncertainties of the capital markets.

Now let's look at one example of technology enhanced learning—an interactive, multimedia CD-ROM. This CD-ROM (Chart 3) provides participants with a self-paced guide to retirement planning and the basics of investing. It is also a hands-on laboratory for becoming familiar with asset allocation.

The software is the tool that lets participants apply what they are learning to their own situation. The video lecture is an instructor-led tutorial for the software. Other video messages can include the importance of participating in the retirement program, portfolio managers describing their funds, the CEO discussing the organization's retirement philosophy, and an explanation of the plan's provisions. Investment guidebooks are examples of reference materials that can be included.

It is apparent that the power of technology-enhanced learning is immense. Its other advantages include:

1. A CD-ROM is much less expensive to produce and distribute than to send trainers all over the country. The cost of written materials will also drop significantly.
2. The quality and content of the CD-ROM can be controlled.

Investment Education: Who's Fooling Whom?

3. It is relatively easy to customize and update. You can deliver specific messages to different audiences.
4. Participants can use CD-ROMs anywhere and at any time. They also control the pace of learning.

In conclusion, when it comes to investment education, plan fiduciaries have three primary responsibilities. They are:

1. Make employees understand that retirement security is their responsibility.
2. Recognize that their responsibility is to provide the basic tools that will allow the participants to help themselves.
3. And demand from vendors quality, leading-edge investment education materials.