Lost in translation

Survey data show investment education not sinking in with employees

By Jerry Kalish

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So, how's that 401(k) investment education working out?

Not real well, if you consider recent survey data.

There's the Retirement Confidence Survey by the Employee Benefit Research Institute, which shows that while 73% of workers saving for retirement used written educational material they received from their employer or employer's retirement plan provider, only 15% found it the most helpful material in saving for retirement.

Then there's a John Hancock survey in which 42% of defined contribution participants indicated they have little or no investment knowledge, and that about 50% believe they possess the skills required to manage their portfolios, but would rather spend time doing other things.

Further, higher education doesn't translate to absorbing investment education, as String Financial's survey in the third quarter of 2008 found that more than one-third of respondents with a four-year college degree were not familiar with dollar-cost averaging, nearly one-quarter were not familiar with asset allocation and 12% were unfamiliar with the concept of compound interest.

The news only gets worse if you look at how research conducted by DALBAR, a firm that develops standards for, and provides research, ratings and rankings to the mutual fund, broker/dealer, discount brokerage, life insurance and banking industries.

For the past 15 years, DALBAR has issued a report that examines the returns investors actually realize and the behaviors that produce those returns. The 2009 report shows that equity, fixed income and asset allocation fund investors experienced average annual losses for all time periods examined except the longest (20 year) time frame - and even those positive returns did not keep pace with the average inflation rate.

And here's the really bad news as it relates to 401(k) plans. While the S&P 500 earned an average return of 8.41% from 1988 to 2008, the average equity investor earned a mere 1.87%, meaning that the cost of uninformed investing was 6.54% per year over that time period.

So if the objective is to increase the potential for adequate retirement income and investment education programs don't seem to be working, then maybe we should be looking at the 6.54% differential not as what DALBAR refers to as the "cost of uninformed investing," but rather as the "cost of going it alone."

That's exactly how many plan sponsors are viewing the problem. A relatively new component is being added to many 401(k) plans - independent investment advice by a registered investment advisor. "Independent" in this new 401(k) service environment means no ties to the fund provider.

There usually are two options in a managed account service:

The first option is one in which the investment advisor provides personalized one-time investment recommendations. After that, participants are responsible for ongoing account monitoring, rebalancing and management. This appeals to participants who like to take an active role in managing their retirement account, and there is usually no cost.

The second option is for participants who don't have the "3 Ts" - time, talent or temperament - to actively manage their account. The investment advisor provides ongoing discretionary investment management for a fee, paid for by the individual participant.

With both options, an independent investment advisor generally assumes fiduciary responsibility for managing participant accounts - not a bad arrangement for the plan fiduciary from a risk-management standpoint. Of course, the fiduciary still retains the responsibility for monitoring the service provider.

The managed account service can appeal to both types of employees: those who feel most comfortable handling everything themselves, and those that don't. In the words of the usual caveat, the investment advisor's past performance is no guarantee of future results. But then again, how's that investment education been working out?

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