Teresa Ghilarducci: Why the 401(k) is a "Failed Experiment"

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by · Jason M. Breslow (https://www.pbs.org/wgbh/frontline/person/jason-m-breslow/) Digital Editor

Teresa Ghilarducci is director of the Schwartz Center for Economic Policy Analysis at The New School for Social Research. The 401(k) system has been a "failed experiment" for middle-class Americans because it was never designed with them in mind, she told FRONTLINE. "It's not the fault of people that they don't have enough savings in their individual retirement account or their 401(k)s," she said. "It's the fault of the system, and the whole system needs to be reformed." This is the edited transcript of an interview conducted Oct. 25, 2012.

[question]I'm going to take you all the way back to 1974. What was the significance of ERISA passing?[/question]

ERISA, the Employee Retirement Income Security Act of 1974, was passed after many people lost their pensions after many years of work, and they were promised pensions, but the company went bankrupt, and there wasn't actually any funds to back up the promise.

The most famous case of that was Studebaker, that was based in South Bend, Ind. And that city [was] filled with people who for 20 years had been promised a pension, and they found themselves in their late 50s without a job or any income.

ERISA was passed to make companies set aside money to back up to promises. And a lot of the bigger companies were doing it anyway, so it codified, or made legal, what the big companies thought [was] the responsible thing to do.

And it was also a time when companies, to be successful, provided pensions, because they realized that turnover costs were really high, that after you trained workers and they left for another firm, it just affected their bottom line. …

So ERISA rode that wave of employer-employee relationships that really valued skilled workers and some loyalty to the job.

[question]And how did that get reversed?[/question]

It wasn't because the need for skilled workers or less turnover got reversed. … What's happening is that [employers] are shedding older workers. At 50 to 55, there's been a huge change in the connection between an employer and an older worker. Now, the reason why this … affects pension plans is because that change in employee relationships [has] come about with the same change of the design of the pension plan.

So we've seen in the 1980s and '90s a shift away from a regular traditional pension plan to something called a 401(k)-type plan. Most call it a defined contribution plan, but most defined contribution plans are 401(k)-type plans. These plans were put into place at the beginning of the 1980s, and it was really meant to serve the needs of executives in a company that already provided pension plans for everybody else.

> "The 401(k) … is one of the only products that Americans buy that they don't know the price of it. It's also one of the products that Americans buy that they don't even know its quality or know how to judge its quality. It's one of the products that Americans buy that they don't know its danger."

The plea from larger corporations to the Internal Revenue Service was: "Please give us a way to let our higher-paid employees save on top of the traditional plan for their retirement. Let us deduct their pay, tax-free, and let them pay taxes later after the accumulation."

So the IRS thought, well, they'll never do it if we allow them to do it, but make that available to all the workers. And the IRS was a little surprised that in fact, company after company started to adopt these 401(k) plans as a supplement to regular pensions.

When workers lost bargaining power because of international trade, because of the decline in unions, that supplement became a primary plan.

But … the biggest trend is not that these traditional plans are moving to defined contribution plans or 401(k) plans. The biggest trend we're picking up is that employers are not providing any way for Americans to save for their retirement. So on top of the shift away from traditional plans to 401(k)'s is actually a [lesser] probability that a firm will even have a retirement account at work.

[question]… Kind of unpack the irony that 401(k)'s were a way to make rich people richer.[/question]

So the end of the 1970s and early '80s was a period of a lot of economic turmoil, but the relationship of the employer and the employee hadn't changed much. … All employers cared about the loyalty of all their workers and wanted to help out their higher-paid managers. They decided to petition the IRS to actually expand their pension offerings, and they provided 401(k)'s as a supplement to the traditional plans.

What's ironic is that as time progressed and regular workers had less bargaining power, less presence in the modern firm, is that this plan that was really built to supplement the retirement accounts for the higher-paid workers became the only vehicle in which lower-paid workers could save for their retirement.

So the structure was always set up against lower-paid or middle-class workers from the very beginning, because it was never intended to be the primary savings vehicles for most Americans.

[question]How was it popularized?[/question]

The 401(k) plan was never organically popular among workers. The fact that workers were faced with decisions about where to invest — they were told that they had to choose how much they had to save for their retirement in order to be comfortable — was never anything that was a superior option to just a regular pension plan. …

But it became popularized with lots of advertising money and a lot of congressional protection that other kinds of financial products and other kinds of products in general didn't have.

For instance, the 401(k) manager, or mutual fund, is one of the only products that Americans buy that they don't know the price of it. It's also one of the products that Americans buy that they don't even know its quality or know how to judge its quality. It's one of the products that Americans buy that they don't know its danger, and it's because the mutual fund industry had been able to protect themselves against regulation that would expose the danger and price of their products.

[question]… How is it possible that our retirement funds, there's so little transparency?[/question]

… The period of the 1980s and '90s was a period in which there were high rates of return, or consistent rates of return in the product. So there was a complicity of belief that the mutual fund industry was regulated by the Securities and Exchange Commission or some other agencies that would just make sure that companies did the right thing and that the market competition would regulate itself.

So there was some faith in the product. It hadn't blown up yet. People liked the [Ford] Pinto until the engines blew up. So it's a matter of complacency. 401(k)'s were new products, and they were working well for a while. …

One of the worst aspects of the 401(k) industry is the conflict of interest. … So the 401(k) industry took fees from customers, paid lobbyists to go to Congress to say: "You don't need fee transparency. People won't really understand it. Let the market thrive, and then through competition, the fees will just be appropriately priced."

And so that was the story year after year when the Congress tried to expose the fees. …

[question]… We all know that banks spend money on lobbying. But was it different than the usual sort of Wall Street kind of shenanigans?[/question]

I think that the rest of Wall Street and the rest of banks were more highly regulated because there was a popular movement against credit cards and against mortgages. …

Even the people who worked in the banks just accepted that they had to reveal what the real checking account fees were and what the real interest rate fees [were]. So there was a culture of regulation among commercial banks. …

The 401(k) industry comes from a different side of Wall Street and a different side of the banking industry. Those were products that used to be available only to the very rich. And they made a deal. Those mutual funds made a deal with Congress, just like hedge funds are now, that look, it's sophisticated consumers that buy our products, and therefore they can understand what the fees are. If you regulate us, all you will do [is] create red tape and take money away from customers. …

[question]Do you remember the first time you heard the term 401(k) and what you thought about it?[/question]

USA Today in the early '90s asked me what I thought about the this new forum of defined contribution plans, and they asked me because I was a new professor and had just finished a huge study of 800 firms and how much money they put aside for their employees.

I had just written a book on how Americans prepare for their retirement, and I knew that Americans really prepared for retirement by paying taxes into Social Security and also saving at work. And I had just finished a study that showed that if employers adopted a 401(k) plan, this new kind of plan, that they actually lowered their pension costs. …

And I wondered what this new forum was. So the early '90s, I just told the news media and everybody about the fact that these 401(k) vehicles seemed to be a way that companies just got out of contributing to their workers' savings plans. …

[question]And yet they became very popular among workers. …[/question]

So when workers were offered a 401(k) plan and their defined benefit plan was frozen or eliminated, workers did say they liked it. But it wasn't because it was their first [choice]; it was because [it was] their only choice.

All of us, when we're faced with something rather than nothing, tend to be optimistic about how that something is going to work. Study after study that asks workers, "Would you prefer a secure retirement plan, or do you prefer a plan where you can decide where to invest, and how much to save?," workers choose the more traditional plan.

They like the supplement; they like the choice. But it doesn't mean they refused a secure retirement plan.

[question]But the markets were booming. It was exciting. We were all sort of gambling on the market, and suddenly we could gamble with our retirement money.[/question]

… The stock market was all over the news media. Personal finance journalists all of a sudden were in high demand. There are lots of people on the radio that have personal finance programs. You had [Jim] Cramer and the *Motley Fool* making investment almost kind of fun and childlike. Cramer reminds me of *Sesame Street*, you

know, running around and honking horns and talking to people about big adult stuff.

All of a sudden, workers were getting some familiarity, like you do when you are exposed to a lot of advertising, with terms that were really in another rarefied world of finance, so that everybody on the street could talk about [large] cap and NASDAQ and the Dow as if it were part of their life.

So the 401(k)'s actually exposed consumers to a whole other world of finance, and the market was in a long-term bubble. It was actually growing.

Now people couldn't see what their accounts were actually doing. That was hidden from view. And in fact, there were lots of articles in that period of time which would survey workers. How much did you earn in your own account? And even very highly educated workers would name a number that actually incorporated their own contributions. So many sophisticated workers — these are engineers; these are highly educated workers — could not separate out the earnings in their accounts, the actual earnings from the stock market from actually the money that they themselves put in. …

[It] would only take a huge financial crisis, like the one we had in 2008, 2009 for people to realize that that account was at risk. And so the industry was able to coast on some satisfaction among the consumers, the workers who were putting money into it, and their employers who thought, "Well, if my employees aren't complaining, I guess it's OK."

And they were able to lobby Congress to say: "Look, if it ain't broke, don't fix it. Don't saddle us with regulation."

[question]… Talk about the growth of the mutual fund industry. What role was Fidelity playing in making 401(k)'s popular?[/question]

In the 1970s, '80s and '90s, we were in … a period of time when the labor force was aging rapidly. … The mutual fund industry was not very well regulated, and they were finding that people were moving into their savings years. A 40-year-old saves more than a 30-year-old, and a 50-year-old saves even more than a 40-year-old. So they were just taking in money hand over fist, and they loved it.

As demand was increasing in their industry, it let them play with it more, offer more financial innovation. So programs in colleges, at MBA schools really ignored engineering, really ignored management, and it was the finance programs that were exploding.

The big investment houses worried less about whether or not the steel company they were investing in had good operations, and they were just interested in creating more financial products. So we had more financial engineering in the 1970s and '80s, more product innovation than we had actual engineering.

But this product innovation, this money flowing into the mutual fund industry because the workforce was getting older, was a way for them not only to create more high-value, high-profit products, but it was also a way for them to consolidate their political power. …

[question]So who were the early players? And how did they get so big?[/question]

The early players were Fidelity, MFS — Massachusetts Financial Services — were the early creators of 401(k)'s. … The early mutual fund companies really were marketing to the very richest Americans. These were Americans that had wealth beyond their house and beyond their company plan.

And all they did was have this financial product that let rich Americans not have to pick on their own which stocks to buy but said, "Hey, we'll give you a fund that has a little bit of everything, and then we'll do a lot of that stock picking for you."

And rich people thought that was a good use of their time and a good use of their money. They would pay a mutual fund manager to pick the stocks, and they would just get a rate of return from a diversified portfolio. So the mutual fund industry was an industry for older rich people. …

[question]When one has a 401(k), you generally have this sort of Chinese menu of really fabulous-sounding options. … Can you give me a sense of what those products are and who makes money off of them?[/question]

… The people who have gotten a job and are asked to invest in their 401(k) are handed really two choices: How much do you want to put into your 401(k), and where do you want to put that money? And they're given a menu of choices about where to put their money. …

We experts have actually analyzed the choices that people make. So one disturbing fact is that if people have 15 choices, they feel the most prudent thing to do would be to diversify their contributions — it makes actually a lot of sense — and they just put 1/15 of their contributions into all their funds. Or they'll ask their co-worker, "So, buddy, what did you put your money in?" Or they just may be in a good mood to put their money toward things that sound like growth, or they may be in a mood to put things in that more sound like value.

There's really no guidance that employers provide, and that makes sense, because if employers provided guidance, they'd be on the hook if they provided the wrong guidance.

So workers are really left on their own to choose among the Chinese menu, and because there's no regulation, there's often not a distinction about whether or not they're even investing in a stock or a bond. And there's nothing on that Chinese menu that reveals the price of that product.

[question]So when they put their money in [these] "value" and "special" and "growth" funds, what happens to that pile of money?[/question]

So we know that 401(k) participants don't invest like a professional would invest. They don't invest in an appropriately diversified portfolio. They don't invest in the lowest fee portfolios. …

Just asking the question, have 401(k) investors done as well as professional investors, done as well as defined benefit investors, or have done [as] well if they had put their money under their mattress, and the sad fact is that 401(k) investors perform the worst among all participants.

Here's a fun fact. For many people who just put their money into a 401(k) and never looked at it again, and happened to have picked a low-fee diversified mutual fund, [they] would have done a lot better than the [401(k)] investor that watched the stock trading shows or followed the investment advice and responsibly tried

to trade every quarter or every year, because the person who tried to be responsible and follow the advice on the news media or in a pamphlet would actually pay such high trading costs that it would take away from their returns.

So we know after 30 years of this 401(k) experiment that people do worse in 401(k) than they would have if their money was in a traditional plan or if it was in a plain vanilla retirement account.

[question]Why do most people not know that?[/question]

Most people don't know that the 401(k) products are toxic and their behavior toward a 401(k) product is toxic because no one has been responsible for providing a safe product.

The Congress has not put itself [out] as a responsible actor. Employers were told, "It's up to your employees to choose," and the banking industry and the mutual fund industry said, "Trust us." ...

So the reason why workers don't know that their 401(k) products and the choices that they make won't yield them enough return and that they're paying high prices is because the products are dangerous, and nobody regulates them.

[question]It almost sounds like ... the mutual funds are mugging widows and grandparents, you know?[/question]

The mutual fund industry [is] doing what they're supposed to do. They're supposed to make money for their shareholders, so they're providing a product to not just widows and our grandparents and older people, but they're providing a product to workers. And the workers are responsible to find out the quality of that product.

There's very little regulation, very little information about those mutual funds, and the mutual fund industry likes it that way, because the less information they have, the higher the fees they can charge. ...

[question]... In this world of [the Charles Schwab ad campaign] "Talk to Chuck" and Fidelity and T. Rowe Price and Prudential, who should I trust?[/question]

... In the 1950s and '60s and '70s, most Americans dealt with the bank because the bank gave them a mortgage; the bank gave them a savings account or a checking account. The bank might have given them a small business loan. And the banks started giving you credit cards.

At the time that the commercial banks provided these products, Congress kept up with them and regulated them. It wasn't without some tension, but the American worker and the banking industry had a well-regulated, familiar relationship.

In the 1980s and '90s, the part of Wall Street that really only interacted with rich people stepped down and expanded their market to the middle class and to ordinary workers, and they were able to expand their high-end business down-market because employers were shedding their traditional plans and providing a do-it-yourself pension plan.

"Most people don't know that the 401(k) products are toxic and their behavior toward a 401(k) product is toxic because no one has been responsible for providing a safe product."

So the changes at the workplace really matched up with changes in the mutual fund industry to expand their market. So the mutual industry started to sell a product that wasn't appropriate for most Americans, and the players there became household names because they went retail. And the advertising budgets of these firms exploded, and they got those advertising budgets from fees that were named education fees or marketing fees or administrative fees.

And so a big part of the advertising industry in this country [has] moved away from cars and clothes and diamonds and [has] moved toward mutual fund products. There's always been an effort of sort of luxury-good providers to make sure that the middle class would kind of grasp and reach, and kind of get those products. I think the mutual fund industry is just part of that down-marketing of a luxury good.

The problem is, it's not just a frill. The problem is that the mutual fund industry has replaced products that all Americans need, which is a secure way to save [for] your retirement in an efficient way.

[question]Is there a campaign that you think was more memorable than any other?[/question]

... The campaign that I thought was going to be the most effective ... was the "Talk to Chuck" campaign. It was talking directly to younger people and to workers to say: "I am going to help you through this process. Just talk to somebody that could be your uncle or your dad," or actually the local banker that used to tell you: "Hey, buddy, you really can't afford that home. Go a little bit cheaper; we'll put 20 percent down."

So the "Talk to Chuck" was a campaign that referred to a world in which you could actually have a partner and a trusted adviser for your financial products, just like you had a trusted teacher that helped you through your education or through your career.

It was a campaign I thought would really take off, and it looks like it has. So I've seen that the mutual fund industry has kind of changed their tactics and are really locking into not the dreams of retirement, but to the anxieties of retirement. And they're hoping that the worried worker will actually trust an adviser.

So I think it's working for the industry, but it's not working for the American public. Many people that I know are paying way too much to their adviser to buy products that are way too expensive for them.

And so we have a system in which in order to be responsible, you're supposed to hire your own adviser, when in the past it was just all you had was a way for you to take your hard-earned money, maybe 5 percent, 10 percent, set it aside, and you knew that you would actually have a stream of income for the rest of your life.

[question]Let's talk about ... the financial adviser that a lot of people get. Who is this person? How qualified are they generally? What are their conflicts of interest and their fiduciary responsibility over the advice they give you?[/question]

Many middle-class workers are consuming a product that was once only a product that very rich people bought, and that was a personal adviser. The big difference is that the rich people would hire a financial adviser that had just a very high fee and knew a lot about taxes and estate planning. Now middle-class workers are getting a product where the adviser is really just a broker or a salesman, so it looks like the kind of product that rich people have, but it's a very different product.

So when you hire a guy, or you have a financial broker, that guy is most often attached to a big financial company. Many people are getting their financial advice from an American Express adviser. They're getting their advice from somebody who they find in a small room at their local bank, who are selling products for their individual retirement account. Or they're talking to a financial adviser that's connected to Charles Schwab or Fidelity or another mutual fund aggregator. And this guy works for that financial company, just like the person who sold you a car works for the dealer or for the auto industry.

Now that guy — and often it's a gal — does have some professional standards they have to meet. They have to pass a couple of licenses, and they have to know something about you — not very much about you, but they want to know if you're a high-risk investor or you want a secure amount of money, and they probe you a little bit.

There's always the standard questions. Do you want to preserve your capital, or do you want to make as much as possible? And based on those questions, they have some rough standards about what kinds of products to put you in. But after that, everything they tell you is really not regulated.

They have a professional standard to their profession, and they have a loyalty standard to the company. They have to make as much money as possible for their company, and their company rewards for selling you the most high-priced, high-profitable standards.

Let me contrast that guy with the guy, the investor that people have in a traditional plan. … When you put a dollar into an ERISA plan or [in]to a traditional plan, that money was protected by a standard called the fiduciary standard. That standard requires everybody running your money to be professionals but also to have loyalty only to you, to the beneficiary. …

They can't put a penny toward an investment that might benefit somebody else or take that benefit into consideration. Even if that investment would save the auto company or the steel company, the investor, the professional has to say, "Does it help my worker or my retiree?"

A professional standard that your guy is guided by is a much lower standard than a duty of loyalty or fiduciary standard. Basically your guy is out for himself to maximize his sales, and the way he does it is to be loyal to the mutual fund. And they try to sell you the most profitable products. …

[question]… So they're the broker-dealer?[/question]

They're the broker-dealers. They're the financial adviser. … There's no difference, but they certainly don't present themselves to you as a broker-dealer. That's the function they serve in the industry.

But you as a worker, or you as a saver in an individual retirement account, you're presented with this guy. In another name, he calls himself, or she calls herself, an adviser. Many people in the industry think that we're going to see a wave of lawsuits against these advisers for even violating their low-level professional standards, because these advisers have only been pushing high-fee products. And as people find out that there's really not enough in their nest egg, they're going to have notes. They're going to have records of the kinds of advice that they were given, and we probably will see a lot of lawsuits to actually push the boundaries of what professional standards mean.

[question]… The Pension Protection Act [of 2006]: Why was this passed, and did it make things better or worse? [/question]

The Pension Protection Act is a lovely sounding name of a law, but it in fact did the opposite of what the name implies. The Pension Protection Act really put the final nail in the coffin of defined benefit plans.

The Pension Protection Act continued the severe and tight regulation of the traditional pension system and gave a lot of leniency to the IRA and to the 401(k) industry. So it continued the asymmetry of regulation.

And what it did was tell defined benefit plans that they had to fund their promises to a much higher degree than they ever had before. It accelerated the payments into the pension plan.

Now, that all sounds good, but the Pension Protection Act did to traditional plans what a law that would say, "Hey, you might have a 30-year mortgage; you now have to fund your mortgage in five years," would do to homeowners.

What it did was accelerate the full funding of many plans, and it forced a lot of plans to terminate, to go bankrupt, because they weren't planning on funding their plans to such a high degree, just like somebody who took out a 30-year mortgage would not be able to fund it all in just five years. …

[question]… Why weren't they regulating where the problem was, which was 401(k)s? Why not have any provision that would protect people that were putting their money in these?[/question]

The Pension Protection Act focused its attention on traditional plans but did not focus its attention [on] the defined contribution world of individual retirement accounts and 401(k) accounts, because the lobbyists for the 401(k) industry was very powerful, and the lobbyists for the traditional pension plans were not as powerful. …

[question]Who's the lobby?[/question]

The lobby for the 401(k) industry is the Investment Company Institute of America. They are called the ICI, and they are growing in Washington, and they are very well funded because their clients were growing and were taking in money from an aging population.

[question]Skip ahead two years later. I believe you testified before a committee. … Talk to me about that day. What happened in that room?[/question]

I testified in Congress in October in 2008. If people remember that period of time, the month before Lehman Brothers had just gone bankrupt, and we had the biggest slide in the financial markets in a couple of decades. And we were just collecting data on what happened to people's 401(k) accounts, and those accounts fell by a trillion dollars.

Everybody overnight who had a 401(k) or an IRA saw their accounts drop by 25 percent on average. But many people saw their accounts drop by half. The 401(k) in October of 2008 had become a 201(k). … I had just published an op-ed in *The New York Times* that said we need to save pensions in the same way that we need to save housing and we need to save the banks.

So I testified in Congress that something drastic had to be done to make sure that people's retirement accounts did not fall any further, and to move forward so they could accumulate enough money in their retirement accounts.

And I said to Congress, "We now have seen that the 401(k) experiment was a failed experiment." This was the event that exposed the flaws in the 401(k) system. And I was right, but the industry pounced on me. And in fact, the lobbyists made jokes with me that I had just helped their business because I could be the one person that personified all the criticisms of the 401(k). I could be the big target, and so they could tell their clients, "Oh, you'd better give us more money as lobbyists, because Congress is going to regulate you once and for all."

Well, they were right. It took four or five years for Congress to regulate them, but now we're seeing that the 401(k) industry has to reveal some of their fees.

[question]What did they criticize you for?[/question]

They criticized me I think for saying that the 401(k) industry is exposed, and here are the list of reasons why the 401(k) industry was always a failed system, was always a flawed structure for ordinary people to save their money.

[question]But help me understand. How is it possible that 2008 happens? People lose half their retirement savings. … Did Congress, did the president, did nobody stand up and say, "Wait a minute, this is a problem"? Silence?[/question]

… The reason why Congress responded to the mortgage crisis, responded to failed banks, was because there were stronger voices for homeowners. There were stronger voices for communities that were facing a bankruptcy of their auto industry. And there wasn't a strong voice for people who were really afraid about their retirement futures.

"The 401(k) in October of 2008 had become a 201(k)."

People [who] were afraid for their retirement futures are dispersed. They're older workers who also might be losing their home and also might be losing their job. So the undercurrent of not having enough money for retirement, that pending crisis just took a back seat to the more immediate crisis of rising unemployment or

home loss. But it doesn't mean it's not as important, and it doesn't mean that it won't strike people when they're most vulnerable. …

So there was silence in Congress because I actually think a lot of congressional representatives, even senators, though they may care, were one step removed from what was happening in the lives of workers. They had better things to do, and the lobbyists for the mutual fund industry were really loud and convincing to say, "Lookit, we're down; if you regulate us or scrutinize us, it's just going to cause more confusion and more lack of confidence." …

[question]"We're not a financial product that needs to be regulated"? …[/question]

I really was a minority voice in Congress that said these 401(k) products are a financial product just like all the financial products. People use these products for a very particular financial goal, and it should be put under a consumer protection agency.

But I lost that battle. The lobbyists for the mutual fund industry were just too strong and too well funded. But these products should be regulated like a financial product. They were never appropriate for the vast middle-class consumption that they are now. And the financial crisis of 2008 just showed that these products need more regulation, and that they're very risky, and they can blow up. …

[question]… In 2009 a company called BrightScope was created. Is this a good thing?[/question]

BrightScope is a for-profit company, and it saw an opportunity to help out employers that really wanted to do the right thing and provide their employees with a choice of products that would be appropriate for them. …

BrightScope does reveal the quality and the fee structure of a particular product in a mutual fund, but it can't help people do the most important thing they have to do when they look at the Chinese menu of choices in a 401(k) system, and that's how to put these pieces together to actually provide a secure retirement income for the rest of their lives. …

[question]As I understand, it only actually looks at 50,000 programs, leaving 600,000 other 401(k) programs without any –[/question]

BrightScope is in the beginning stages. It's looking at all the products in the 401(k) industry. It hopes to look at all of the products. It only looks at a fraction of the products, the most popular products. And as it looks at one, the products change, so they have a very big job. …

[question]In 2010, I guess sometime this year, your friend Phyllis Borzi, [the assistant secretary for employee benefits security in the Employee Benefits Security Administration of the Department of Labor], finally did something about getting some transparency. What did she do, and how did she get there?[/question]

One of the bright lights in this 30-year history of 401(k) growth and the lack of regulation has been the Obama administration's assistant secretary for pensions, Phyllis Borzi. She came to office … and said her top priority was to regulate this fairly unregulated industry, that at least workers would be able to find out what the price of their product is. They might not be able to find out the quality of their product, but at least they'll be able to find out the price.

So starting in 2010, she wrote regulations. She wrote rules about what the mutual fund industry would have to reveal to workers about how much their 401(k) fees cost.

And it's taken two years for those regulations to come into effect. So in the last months of 2012, employers are going to have to reveal to their employees what the price of their product is.

It goes in the right direction, this regulation, but it doesn't go all the way, because even though people will be able to know in some uniform way what their fees are, they won't be able to know the quality of the product, and they won't actually have all the fees revealed. They won't know all the things that they do that actually cause those fees to go up, like buy and sell the product too frequently.

[question]... What was the opposition that she faced?[/question]

So Phyllis Borzi, her brilliance was to actually not go to Congress and ask Congress to change the law to make fees revealed. ... What she did was just pass a regulatory rule. ...

[question]So she just did it as a matter of course?[/question]

Yeah, so Phyllis Borzi just did it as a matter of course in regulating these funds and figured out a way not to have to go to Congress. It took a long time, because even trying to implement a new rule can be slowed down by the lobbyists.

[question]When this rule was enacted, what impact did it have?[/question]

It activated the lobbyists to actually try to slow down the implementation. So when this rule was enacted, there was a change in how it would be rolled out, and we haven't seen what the reaction to the rule will be yet. We're talking now in the fall of 2012, and not all workers have seen the documents that revealed the fees.

I think that it will have some effect, but not the kind of effect that we need to make these 401(k) plans work better for workers. It's a step in the right direction to regulate these products as a financial product, but it doesn't go as far as the rules that regulate mortgages or other financial products.

[question]You also have a student, Robert Hiltonsmith. Talk to me about his work and what significance it's had. [/question]

So Robert Hiltonsmith authored a study on 401(k) fees (http://www.demos.org/publication/retirement-savings-drain-hidden-excessive-costs-401ks). It's one of those studies that actually expose[s] a product. ... This study really unpacked the kinds of hidden fees and direct fees that workers pay.

And what it did finally is to show that these fees add up, that if you pay these fees and these retail products, you're going to erode your retirement savings by 20 to 30 percent, even if the stock market behaved itself, and even if you saved according to the advice to save 5 to 10 percent of your income without doing anything untoward at all. ...

So what this report showed is that the 401(k) fees are corrosive over time. They look small at the very beginning. They're hidden at the very beginning, but the product itself is too expensive for retirement savings. ...

[question]What was the reaction when that report came out?[/question]

The high-fee report came out in the summer, and the reaction has been explosive. The consumer activists, the consumer reports finally started paying attention to these 401(k) products as just another financial product. Oh, my gosh! We should be paying attention to these as we paid attention to high credit card fees or to subprime mortgages.

And so there's a lot of popular exposure in publications that go to middle-class workers to say: "Be aware. These products may not be delivering the kinds of service that they promise." …

The reaction I hope would be not better products from the industry but a wholesale restructuring of the way Americans save for their retirement accounts.

[question]When we talked to mutual funds, their managers tell us that the fees are justified. They work really hard to figure out how to invest people's money.[/question]

… The mutual fund industry [is] filled with lots of earnest people who do want to help people save for their retirement. But they're actually selling a high-speed racecar to people who just want a secure car to get them to retirement.

So even though they're trying to sell a racecar, a high-end luxury car at the lowest fee possible, and they'd be able to justify that a high fee is necessary for this high-performance product, it's not the product that most people need. …

[question]Why is this a product that's not working? What exactly is wrong with the product?[/question]

The product was always really built for a different kind of consumer. A mutual fund is really there for people who have already saved enough for their retirement and in an institutional long-term investment product, who have already paid off their house and want to take their money and top off their [security] base for retirement.

It's not an appropriate product for people who need to save a part of their paycheck every paycheck in order to have money for a long-term need for the rest of their lives.

[question]Is an IRA a better product?[/question]

An individual retirement account is very similar to a 401(k) except it's worse. The IRA is one of the worst places to save your money. At least the 401(k) has some scrutiny by an employer and has a more sophisticated buyer than an IRA buyer has. …

Both places are appropriate for people who want to top off their retirement savings or want to play with their savings to maybe earn a little bit of money. But it's an inappropriate vehicle to provide a base of support for long-term savings. The IRA and the 401(k) do not have low-cost, long-term savings vehicles in them.

[question]Anybody listening to you would say, "I might as well just put my money under my mattress." Is that a good idea?[/question]

Many people don't have any choices but to go to a 401(k) or to an IRA. Hiding your money in a piggy bank or under your mattress is not a good idea. You're going to lose money just because of inflation.

So if you are going to save your money in an individual retirement account and a 401(k), the best thing to do is to demand from your investment adviser that you want a passive index account. These are [the] kind of accounts that Vanguard [has], … that has a loyalty to make money but doesn't have any shareholders.

But the problem is, the person who wants to save their money in the lowest fee possible [is] going to be met with resistance from their guy. Their adviser doesn't make any money if you put your money into a passive account. So anybody listening to me will just have to be strong, just like you're strong when you buy a used car. You have to go armed with this sentence — "I want a passive index account" — and just say that sentence over and over and over again. Your guy, your broker-dealer, your adviser is not going to like what you demand. But at the end of the day, you have to buy only that product that's appropriate for you. That's not going to be easy. …

[question]Why is a passive index fund better than a 401(k)?[/question]

A passive index fund is a more appropriate fund because what an index fund is, [it] just takes a little piece of the companies that are in an index. So there's a Standard & Poor index of 500 companies, the S&P 500. But there are even indexes that are larger. The Russell 3,000 — that's 3,000 companies.

And basically a computer chooses a portion of those 500 or 3,000 companies and puts it into your account. And a computer doing that automatically doesn't have a mortgage to pay or a vacation home to pay or doesn't require a salary. It doesn't have a sales force attached to it, and it doesn't have a big advertising budget.

All it does is take a little piece of the market and puts it into your account at a very low fee. And for over 30 years that we've been able to compare active managers to a passive manager, the passive manager does better over a period of time. ….

[question]Let's talk about your op-ed. … Tell me about writing this piece, how you came up with the idea and what impact it had.[/question]

I wrote a piece that was called "Our Ridiculous Approach to Retirement," (http://www.nytimes.com/2012/07/22/opinion/sunday/our-ridiculous-approach-to-retirement.html) and that piece was just written out of frustration about the 30-year history of our retirement policy in this country, and also real empathy with people who were telling me that they were very afraid of retirement.

These were low-income people, these were middle-class people, and these were even rich people who said, "I don't think I have enough." And they were talking about something that was very basic to their needs: "I just want to know that I have enough money to live until I die."

> "It's not the fault of people that they don't have enough savings in their individual retirement account or their 401(k)s. It's the fault of the system, and the whole system needs to be reformed."

And the form of their worry came about in different ways: “I don’t have enough money now. How could I possibly have enough money when I retire?”; or, … “I know my employer is going to fire me because I’m too old, but I also know that I have to work longer.” Or the anxiety about retirement comes out among healthy, rich people that says, “Hey, I think I’m going to live until 100, and I don’t have enough money for that.”

… It’s not the fault of people that they don’t have enough savings in their individual retirement account or their 401(k)s. It’s the fault of the system, and the whole system needs to be reformed. People who are worried should not be victims and blame themselves. … Human beings are not the problem in this system. It’s the system that’s not appropriately structured for the human beings that are in it.

[question]The banks will say, “People are just not saving enough.”[/question]

The industry, the banks, the mutual fund industry pivot the concern of workers by saying: “Well, you victims have your own selves to blame for not knowing what a stock and a bond was early on in your life, for not realizing when you were a young worker forming a family that you also had to save for your retirement along with your house, along with your unemployment, along with your child’s education.” …

So the banks are wrong when they tell workers, “You just haven’t saved enough.” Before the mutual fund industry took off and the 401(k) industry was able to protect itself from regulation, people did save enough for their retirement.

When people were in traditional pension plans, they saved 5 to 10 percent in their retirement accounts, along with saving for their house and saving for their child’s education, because the system was well structured for them to save for their retirement account.

It’s a false accusation that people didn’t save enough, or can’t save enough, because they want to live like grasshoppers and just consume all of their money now. It’s just not true. People will save appropriately if they’re in the proper vehicle. …

What we need in this country is not a voluntary, do-it-yourself saving system. It’s completely inappropriate for the way we live. We need a structure that expands upon our Social Security structure, that puts on top of Social Security kind of a Social Security plus, where we can save and have a guaranteed retirement account. …

[question]Who’s listening to you?[/question]

I hope that people who are now struggling with keeping their jobs, over the age of 45, and are also struggling to save for their retirement, that they know that it’s not their fault that they don’t have enough money. …

[question]When you talk about these workers, … there was a shocking statistic there about how much you needed to have when you retired.[/question]

… You need eight to 10 to 20 times the amount of your annual income when you retire in your retirement account to live comfortably.

In my article, I gave a top number of about $1 million to $2 million. But for a middle-class worker, having a million dollars when you retire will keep you comfortable for the end of your life. Having $2 million will keep you very comfortable with no risk at all of falling below your retirement living and have some inheritance left over.

[question]How is the average middle-class worker going to amass $1 million by the time they retire?[/question]

Well, the average middle-class worker who had a traditional plan actually amassed close to the equivalent of a million dollars, but it never was expressed as a million dollars. It was expressed as a defined benefit for the rest of your life. Most of us actually are amassing a quarter of a million dollars, half a million dollars in our Social Security accounts.

Our Medicare account, our Social Security accounts, are worth almost a million dollars. We could amass a high-value asset when we're in these guaranteed insurance products fairly easily. All it is is a contribution every paycheck.

But the 401(k) requirement is to amass it all in liquid accounts, and that's nearly impossible. So what we need to do is to amass a million dollars' worth of a promise of payment for the rest of your life into accounts that are more like insurance products.

[question]So you believe in annuities?[/question]

Annuities are products that provide a stream of income for the rest of your life. They're provided by the government, and they're also provided by employers in a traditional plan, and they're also provided commercially in the private market.

They're provided by the government through the Social Security system. When we put 6 percent of our pay, another 6 percent and some change [that] our employer puts on our behalf into the Social Security system, we are buying the right to an annuity for the rest of our life. We don't call it an annuity; we call it a Social Security benefit.

When we work for an employer that has a traditional pension plan, we're putting 5 percent of our pay, 7 percent, 10 percent of our money toward a promise to pay you for the rest of your life.

When we try to go buy an annuity from an insurance market, we're trying to take a hunk of money, $50,000 or even a million dollars, and go out into the market and say: "Hey, insurance company, here's a lump sum. In return, give me the promise that you'll pay me a stream of income for the rest of [my] life."

The problem with going to the commercial annuity market with our 401(k) or IRA assets is that the insurance company doesn't provide annuity to everybody else. They only provide annuities to people who want it, and they're suspicious.

If you take your million dollars and want a stream of income for the rest of your life, they know that you know something they don't. They know that you think that you're going to live a very, very long time. People that have terminal cancer don't go to an annuity company and say, "I want money for the rest of my life." They know they're going to die sooner than the average person.

So the private annuity company has to charge you for that risk of living too long, and therefore they're giving you a bad deal because it's a private annuity market. It's a lot like sick people having to go out and having to buy private health insurance. The cost is way too high.

So I do not recommend that people take their 401(k) money or their IRA money and buy a commercial annuity. But what I'm saying is that everybody should have access to a low-priced, fair annuity product. But you can't do that in the private market.

[question]When you think about 10,000 baby boomers that are retiring every day, what scares you the most?[/question]

I'm really worried about that, because 10,000 baby boomers, 8,000 baby boomers are going to retire per day for the next 15, 17 years. We've done projections about how much money each of these people [is] going to have for the next 15 years, and we're dismayed — actually much more. [We're] really panicked that many of these people will not have enough money to stay out of poverty.

Half of middle-class workers will be poor or near poor the day they hit 65, ... because they don't have enough money saved in their retirement accounts and because their house values have fallen so severely.

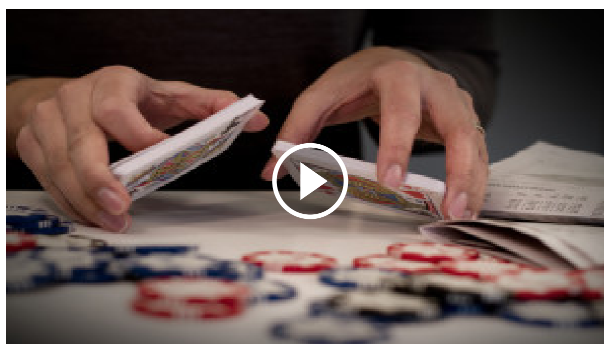
Those folks are going to try to work longer, and they're meeting a labor market that is much more hostile to older workers than it has been in the past. They're also meeting a labor market with very high unemployment. ...

So we are finding that cities and states are now becoming aware that they have an older, vulnerable population on their hands. ...

[question]Are you optimistic?[/question]

I am, because of all the attention paid to this problem by state legislatures and by governors and by state treasurers. In fact, just last month the California Legislature and the governor decided they can't wait for the federal government to do something about it, and they just passed legislation that will make it easier for all workers to save in a guaranteed retirement account.

Now, those accounts will be a competitor for Wall Street. But these are systems that will make 401(k)'s and IRAs just much more high-performing vehicles, so everybody should benefit. ... So if the federal government won't do something about their citizens' retirement crisis, there are other local governments and state governments that will. ...



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