Why 401(k) plans & Mutual Funds are **undermining** investors’ financial security

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### 401(k)s: The New Retirement Plan, For Better or Worse

#### Alicia Munnell,
Director, Boston College Center for Retirement Research

Alicia Munnell is the Drucker Professor of Management Sciences at Boston College’s Carroll School of Management. She has authored highly acclaimed books and conducted studies that are essential resources for academics, policymakers, and the financial industry.

“No one thought this out. The 401(k) plans were originally introduced as supplemental plans only. No one ever said, "Oh, let's end traditional pensions and replace them with 401(k) plans."

#### Elizabeth Warren,
Harvard Law School

Elizabeth Warren is an expert in Pension Law in America. She has conducted extensive studies on how the Employee Retirement Income Security Act (ERISA)—which was designed to protect employees and retirees—has been **exploited** to the benefit of corporations and banks.

“Much of the push toward 401(k)s was not driven by ordinary workers. It was **driven by CEOs** looking for tax protection in order to maximize the value of their retirements. ... If you read the legislative history...of the 401(k), it's clear this was a tax break for the folks who made **lots and lots of money**. ...That's the **irony**. What it was designed for and what it's being put to use for are totally different from each other.”

#### Brooks Hamilton,
Benefits consultant, Brooks Hamilton & Partners

Brooks Hamilton is founder of Brooks Hamilton & Partners, which designs 401(k) plans for corporate clients such as Neiman Marcus and Frito-Lay. In this interview, Hamilton discusses his long career in the benefits industry, the explosive growth of 401(k) plans and the mutual fund industry in the 1980s and '90s, his discovery of a "**yield disparity**" in 401(k) plans and how this disparity threatens to **undermine** the entire 401(k) retirement system.
“Are you saying a storm is coming? A perfect legal storm is approaching ... workers are going to retire into despair and run out of money. ... They played the game (401K); they were faithful, loyal employees. They are old and gray and broke.”

The 401(k) and the Mutual Fund Industry

Brooks Hamilton:
“Forcing novices ... to direct their own investments was not really a good thing to do. I used to ask the CEO, CFO of my major clients, ... often in a conference room [after] some young employee would bring in coffee, and as they would be leaving, I would ask the CEO,

‘Would you allow that employee to direct the investment of your account in the 401(k) plan?’ They always thought I was some kind of idiot: ‘Of course not. I wouldn't let them touch my account with a 10-foot pole.’ And I said, ‘But you force them to manage their own!’ And they are running their money into the ground.”

“If Fidelity manages my account, does that mean I save more? Not at all... Does it mean I earn more? Probably not. Because... it's fees and expenses, and unfortunately most fees and expenses are not even revealed.”

“John Bogle (founder of Vanguard) testified before the Senate in November of 2003. He basically said... from [1984] to 2002, when the [stock] market did a 12 percent [annual] return, the average investor [in mutual funds], according to Mutual Fund Data Collector DALBAR, did 2.7 percent.

“That's 2.7 percent growth per year... So now the solution is to turn it over to them? I thought that's where we had been. And it hasn't worked too well. It hasn't worked too well. ...I regret the fact that our retirement income strategy in major companies is the 401(k)... I know it's flawed.”

David Wray, President, Profit Sharing / 401(k) Council of America

David L. Wray is President of the Profit Sharing/401k Council of America (PSCA), a nonprofit advocacy group for 401(k)s. In this interview, Wray discusses why companies are choosing 401(k) plans over traditional lifetime pension plans, what employees need to save for retirement, and the problems with 401(k) plans.

“I agree with Mr. Bogle. ... Fees can eat up a lot of your gains. ... Employees have more money
than they would have if they didn't save at all, but certainly they're not in as advantageous a position as someone who can have an S&P [Standard & Poor's] 500 index fund.

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John C. Bogle,
Founder, Vanguard Mutual Fund Firm

John C. Bogle, 77, is Founder of The Vanguard Group, Inc. He created Vanguard in 1974 and served as Chairman and Chief Executive Officer until 1996. He had been associated with a predecessor company since 1951, immediately following his graduation from Princeton University, magna cum laude in Economics.

In 2004, TIME magazine named Mr. Bogle as one of the world's 100 most powerful and influential people, and Institutional Investor presented him with its Lifetime Achievement Award. In 1999, Fortune designated him as one of the investment industry's four "Giants of the 20th Century." Mr. Bogle served as Chairman of the Board of Governors of the Investment Company Institute in 1969-1970. In 1997, he was appointed by then-U.S. Securities and Exchange Commission Chairman Arthur Levitt to serve as a member of the Standard & Poor's Corporation's Corporate Governance Committee.

John Bogle: "TYRANNY OF COMPOUNDING COSTS"

"Investors should realize [they] don't get the market return. ... So if I do your average, what percentage of your net growth is going to fees in a 401(k) plan?

"Let me give you [an] example: ...an individual who is 20 years old today starting to accumulate for retirement. That person has about 45 years to go before retirement -- 20 to 65 -- and then, if you believe the actuarial tables, another 20 years to go before death mercifully brings his or her life to a close. So that's 65 years of investing.

"If you invest $1,000 at the beginning of that time and earn 8%, that $1,000 will grow ... to around $140,000. Now, the financial system -- the mutual fund system in this case -- will take about two and a half percentage points out of that return, so you will have...a net return of 5.5 percent, and your $1,000 will grow to approximately $30,000.

"$110,000 dollars goes to the financial system and $30,000 to you, the investor.

"Think about that. That means the financial system put up zero percent of the capital and took zero percent of the risk and got almost 80 percent of the return, and you, the investor in this long time period, an investment lifetime, put up 100 percent of the capital, took 100 percent of the risk, and got only a little bit over 20 percent of the return.

"That is a financial system that is failing investors because of those costs of financial advice and brokerage, some hidden--some out in plain sight--that investors face today.

[For clarification] "In the long run [over a 65 year period of investing], the financial system is keeping 80% of the value; and only 20% goes to you, the investor."
[In a shorter time frame]: “In a given year, it's about 80% to you and 20% to the financial system, so if you look at 10 to 15 years, you're probably talking about 60% to you and 40% to the financial system maybe over 20 years, something like that. But the longer the period, the greater the impact of that tyranny of compounding costs is.

[The Solution]: “It's not just me who is saying: 'index the market, capture the market's return, get costs out of the system, be bored to death and have a comfortable retirement.'“