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Congress Should Improve Workers' Access to Better Advice for Retirement Investing

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Millions of workers with 401(k) retirement plans may not be receiving the most for their money or may even be making mistakes that will cost them thousands of dollars because they lack easy access to investment advice. However, this situation is simple to remedy, and Congress should act promptly to ensure that workers get the information they need.

The most practical approach is contained in the Pension Security Act (H.R. 1000), passed by the House of Representatives on May 14 by a vote of 271 to 157. This legislation includes language that would allow workers with 401(k) retirement plans to receive investment advice. Senator Mike Enzi (R–WY) has introduced S. 1698, which includes the same language, in the Senate.

- Workers need more explicit information when faced with a long list of potential investment choices, many of which seem very similar.
- The practical approach found in H.R. 1000 and S. 1698 would likely improve access to this needed information.

Need for Additional Investment Advice and Financial Education. At the end of 2001, the Employee Benefit Research Institute found that about 45 million Americans owned more than $2 trillion in assets invested in almost 350,000 401(k) retirement plans. Other types of defined contribution plans held an additional $1 trillion in assets.

While workers tend to welcome the opportunity to control their own investments, they may lack some of the tools necessary to do so. According to former Securities and Exchange Commission Chairman Arthur Levitt, more than half of Americans do not know the difference between a stock and a bond. A 2001 survey by the American Council of Life Insurance found that only 51 percent of workers surveyed felt "very comfortable" in making investment choices in their retirement plans.

Financial education is available, but the effectiveness of these courses varies widely. While workers may leave such a course motivated to increase their savings or change their investments, they may not act on those intentions.

How ERISA Makes Financial Education Harder. Simple financial education that covers the difference between stocks and bonds, as well as basic information about optimal asset allocation, is a good start, but it does not go far enough. Workers need more explicit information when faced with a long list of potential investment choices, many of which seem very similar. Investment advice would make it much easier for workers to choose good investments.

Unfortunately, the Employee Retirement Income Security Act (ERISA), the law that governs employer-offered retirement plans, prohibits compa-

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nies that manage an employer's retirement plan or offer products included in the plan from offering any sort of investment advice. Some of this prohibition is wise because it prevents financial institutions from selling workers high-cost investments that mainly benefit the seller. However, the provision is so broad that it also effectively prevents them from pointing out investment choices that would help a worker to meet his or her goals. Revising ERISA to allow objective investment advice would help workers to better manage their assets.

A Responsible Approach to Reform. H.R. 1000 and S. 1698 amend ERISA to allow a "fiduciary advisor" to offer prudent and objective investment advice that is solely in the interest of retirement plan participants. Plan managers would be required to select the best advisors available and monitor their activities. The advisors would have to disclose in writing their relationship to any company that offers products through the retirement plan as well as any fees or other compensation that they would receive. These disclosures would have to be made when the relationship is established and annually thereafter. Workers would have the ability to accept or reject any investment advice they receive.

The legislation ensures that workers will not be exploited by subjecting the advisor to strict personal liability and disclosure standards. Fiduciary advisors would be strictly limited to individuals and institutions licensed and regulated by either federal or state laws. Those advisors would be subject to discipline and/or recourse through the respective federal or state financial laws as well as a series of additional penalties and liabilities included in ERISA and other laws.

In theory, the best way to avoid any conflicts of interest would be to require that all investment advisors have no business connection to any company that either manages or provides products to the retirement plan. This approach is supported by Senator Jeff Bingaman (D–NM) and was included in recent pension legislation approved by the Senate Finance Committee.

In practice, however, the Bingaman approach has two major drawbacks. First, it eliminates a sizeable number of potential advisors, and because retirement plans change some investment choices fairly regularly, an advisor who was permitted one year might be prohibited the next. Second, independent advisors must be paid by the pension plan since there is no chance that his or her company will generate any other fees from the plan. As a result, only large and successful companies will be able to offer this service. Under the Bingaman approach, many of those who need it most will not have any access to investment advice.

Conclusion. Worker-managed pension and investment plans require a certain amount of information to be successful. Either the plan must be structured to allow for a default investment that yields the best outcome for the owner, or the worker must have access to high-quality financial education and investment advice. This advice is especially important when the worker faces a long list of investment choices.

Congress should act promptly to ensure that investment advice is available to workers with defined contribution retirement plans. The practical approach found in H.R. 1000 and S. 1698 would be much more likely to improve access to this needed information than the Bingaman approach. The sooner workers can get access to investment advice, the sooner their retirement security will improve.

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