



# *Maryland* INVESTOR

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## Fixing the 401(k):

*Smashing the myths of the current system*

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*Smashing the myths of the current system*  
**Fixing the 401(k)**

by William Slaughter  
photographs by Brendan Cavanaugh

**R**arely does a topic or subject person cause such an immediate desire for me to want to know more information in such an immediate manner as did the topic of how broken the 401(k) plans are in many Maryland companies and for that matter all over the country as I learned in a book

written by a local Wealth Manager and 401(k) expert of Josh Itzoe. *Maryland Investor* featured his book *Fixing the 401(k)* in the who's Making News Section of our September issue and I immediately knew that I needed to read the book and find out more about the subject and the author. I have had



*Josh Itzoe, Principal at Greenspring Wealth Management  
and author of Fixing the 401(k).*

many conversations with people about 401(k) plans, their make up, performance and practicality as useful components of a retirement plans over the years. The pessimist inside of me always felt they were better for the planners than they were for the participants.

I never did any research about 401(k) plans to either support or dismiss my suspicions but through the years it was a sentiment that was shared by many fellow workers and conversationalists. I knew it wasn't just me who had reservations about how well they did or didn't work. No matter what you know, believe or suspect about 401(k) plans, Josh's book is a must read for any investor, plan administrator, plan participant or anyone else interested in saving for retirement.

Depending on who you are, his book might help you save more money for your own retirement or it might help you save your own rear end from becoming the target of a law suit. If you read this book you will learn everything there is to know about 401(k) plans that you probably didn't know and you will learn about the enormous responsibilities the Fiduciaries managing these 401(k) plans have to help employees retire successfully.

Make no mistake that this article is not an infomercial or paid placement for Josh and his company but rather a very accurate dissection and analysis of the 401(k) system as a whole. You will find that as investors we all need to be more informed about the structures of these plans, how they work, who profits, how the players are compensated, who is to be held accountable for their administration and what we can all do to make sure that we as Americans are able to plan



and save for a successful retirement.

Before we decided to run this article we researched the subject and found that there is a mountain of irrefutable information on 401(k) plans that mirrors what Josh has condensed into his book. It would take another twelve pages to give you the links and references to support this claim.

I have said this many times and firmly believe that, if we take one quarter the time and effort we expend on following our favorite professional sports team and devote that time and effort to the planning and execution of our financial lives, we would be ten times better off financially than we are today. *Maryland Investor Magazine* visited the offices of Greenspring Wealth Management in Towson, Maryland, and spoke to Josh Itzoe to get in depth answers about the book he wrote and what questions we should all be asking ourselves if we are in any way touched or a part of a 401(k) plan as part of our overall retirement plans.

**Mi:** In the preface to your book, you state that “fear and greed play a large role in the world of financial

services...” In light of the market crash last year and the attention brought to the financial markets/industry. Do you feel that sentiment is changing or staying the same?

**Ji:** Fear and greed have always been a part of investor psychology and I believe always will be. I also believe the financial services industry knows how to play off these powerful emotions from a marketing standpoint and there's nothing that has happened since the book was published that has changed my opinion. At the end of the day, the financial services industry often operates as one big sales and marketing machine, usually placing its own interests ahead of the interest of clients. Most investors would be surprised to learn that their brokers, advisors, agents, consultants, etc. are not held to a fiduciary standard which legally requires them to disclose conflicts of interest or do what's in the clients' best interest. I think this is the primary reason why our industry often isn't viewed by the public as a “profession” and, in most cases, I'd agree with that sentiment. To be considered a professional you need

to work in such a manner. I strongly believe that every financial professional should be held to a fiduciary standard when advising clients because there is so much trust involved. It's also a big reason why I am so passionate about what I do and why I wrote the book—as a way to “fix” many of the problems and issues I think plague the retirement plan industry and negatively affect workers ability to retire successfully. Unfortunately, my ideas don't always make me the most popular personal at industry cocktail parties!

**Mi:** The title of your book is *Fixing the 401(k)*, which you chose because you believe the industry is broken in many ways. What percentage of Maryland based 401(k) plans overall do you feel are broken?

**Ji:** Of the plans I review within Maryland, as well as across the country, I can confidently say that at least 95% are broken according to how we believe the ideal 401(k) should be designed and implemented. Sounds pretty staggering but you have to remember that we are looking at the whole plan from the inside out and making sure that everyone who is responsible for implementing the plan, everyone participating in the plan, the plan strategy, the inner workings of the plan and the plan monitoring are all in accordance with our methodology for complete compliance, efficiency and effectiveness. We believe the *Fixing the 401(k)* approach is the best way to implement a high quality, low risk, cost effective, transparent, compliant and easy-to-use retirement plan that

does what it should, namely, help its participants accumulate as much money as possible at the lowest reasonable cost.

**Mi:** Is there any plan size that is more broken than others or would you state they are equally broken no matter what the plan size?

**Ji:** Smaller plans are generally in much worse shape than larger plans. The Small Business Administration defines a small business as an independent business having fewer than 500 employees and small firms represent 99.7 percent of all employer firms and employ just over half of all private sector workers. Sadly, since most small plans are sponsored by small business, this means that most of America's



workers are part of a plan that may not be working the way it could be or should be. Most small plans are strapped for resources and because of this you may have one or two key people wearing many different hats and the attention they give to their 401(k) plans can easily get lost in the other seemingly more important duties that they are faced with while running a company during difficult times such as we see today. To illustrate my point, I was recently interviewed by a major financial publication about this very topic and the article included a quote from a business owner who said, "The 401(k)? That's the least of my problems." While most people responsible for their company's 401(k) plan won't be so direct, I've found this is often the prevailing sentiment. Larger companies typically have a better understanding of their legal duties and responsibilities and will take a more comprehensive and formalized approach to oversight and decision-making. Larger companies also have the resources to employ more specialized experts which usually lead to a better performing plan. However, this doesn't mean that we don't come across a lot of large plans that are just as broken, if not more, than some smaller plans. We do.

**Mi:** You state that the two biggest problems in the industry are conflicts of interest and fee disclosure. Which of these two do you feel is the bigger problem and why?

**Ji:** Actually, fee disclosure and conflicts of interest are closely connected on many levels and go hand-in-hand. There is no question that fee disclosure is the hot topic of the day from a regulatory and legal standpoint and a lack of disclosure often leads to higher than necessary costs. And make no mistake, costs matter in a big way and often have an inverse relationship

with returns and, ultimately, account balances. Many plan participants and administrators have no idea of the fees they are paying for when they set up a plan. Many of the fees are hidden, buried or just plain unable to be truly quantified such as the transactions costs incurred by some mutual funds that excessively trade securities during a year and thus incur more fees that diminish the overall return of the fund. Greater transparency leads to greater accountability. It amazes me that many companies have no idea how much money their service providers are actually making but it happens all the time.

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**Mi:** In your book you wrote extensively about fiduciary responsibility. How much do you believe that plan sponsors, employers and employees understand about this responsibility? What do you feel will be the motivating factor for companies to fix their plans and adhere to the fiduciary responsibility they have with respect to their 401(k) plans.

**Ji:** Unfortunately, from my experience, very little is understood. One of the first questions I ask in meetings with prospective clients is whether they feel like they are doing a good job fulfilling their fiduciary obligations related to the retirement plan. Most all say "yes". Next, I ask whether they can tell me their four specific fiduciary duties as required by law. So far, I've never had anyone be able to answer my question. Finally, I submit to them that if they think they are doing a good job, but don't even know what's required of them, whether they think there is a high likelihood that they

aren't doing as good a job as they think they are or could be doing. Most agree and it can be a sobering moment when reality hits.

**Mi:** What percentage of Maryland 401(k) plans do you believe could be or are in violation of the Employee Retirement Income Security Act of 1974 (ERISA) which is the law that governs retirement plans and are therefore open to possibly being the target of a law suit?

**Ji:** ERISA is extremely complex and it would be safe to say that every plan could be in violation in some way or another. Some infractions are relatively minor and can be easily remedied.

Other issues can range from serious to extremely serious and involve significant penalties and, in some cases, criminal proceedings against the plan fiduciaries.

**Mi:** Are there any one or two factors that commonly occur triggering law suits against companies and their 401(k) plans?

**Ji:** The main factor in most current litigation relates to excessive fees being paid out of the plan and by participants. So far, very large companies have been targeted by lawsuits from plan participants because there is more money to go after. However, there was a recent lawsuit regarding excessive fees that was announced involving a \$2 million plan with only 30 participants and I fully expect litigation to continue to move down market into the smaller plan space.

**Mi:** You state that part of what makes the retirement plan industry so confusing is the number of different service providers who are involved in the process. I counted 12 "players" as you called them, in this field. How many players do you think should be involved to effectively give employees

and employers the best plan options?

**Ji:** The answer to this can differ according to the size and needs of the plan but a successful plan should have the following service providers that will most likely ensure success for all involved: A plan administrator and recordkeeper are necessary to provide things like administration and compliance support, employee communications, and enrollment services for the plan participants. Every plan with more than 100 participants must be audited annually by a qualified CPA firm and I also recommend that plans of every size should have a relationship with an ERISA attorney. Finally, I have an obvious conflict of interest, but I believe a truly independent advisory firm who specializes in this area and serves in a fiduciary capacity is critical to the success of a plan by providing objective investment and fiduciary advice.

**Mi:** Your chapter titled “Protecting Participants from Themselves” explains that you feel participants are better off investing in a qualified default investment alternative (QDIA). These types of investments include target retirement date mutual funds, lifestyle mutual funds or custom-managed portfolios which are designed and managed by a professional investment advisor. The plan participant should then choose one portfolio according to their risk tolerance and time horizon rather than trying to put a portfolio together by themselves with 30 different mutual funds. What percentage of companies in Maryland use your preferred method?

**Ji:** Most plans we see typically include these options to some extent. For instance, target retirement date funds are very prevalent within the industry and most plans include them as options. Unfortunately, there are several issues

with how they are generally utilized. First, most participants fail to use these types of investments correctly which leads to poor or uneven performance. These options are pre-allocated and well diversified and meant to serve as a “one-stop shop” from an investing standpoint—this means that participants should select the most appropriate option for their situation and then put all their money and future contributions into that fund. Instead, in the name of “diversification” we see most participants put half their money in a target date fund and the other half in a number of other mutual funds. This actually defeats the purpose of using this type of investment vehicle

***The vast majority of active managers fail to outperform their comparable indexes, usually anywhere from 50-80% in any given year.***

by throwing the allocation out of balance and can expose the participant to either too much or too little risk. Second, target date and lifestyle funds are often from a single mutual fund company and usually have all proprietary mutual funds which lead to conflicts of interest, a loss of investment flexibility and potential fiduciary problems. Most importantly, the reality is that the vast majority of participants are ill-equipped to make their own investment decisions and there is a growing body of data that supports this idea. For instance, in my book I cite a study that evaluated the performance of nearly 15,000 participants over a 10-year period, comparing the results of those who chose to make their own decisions versus those who selected a professionally managed option like a lifestyle fund. The results showed that the “do-it-yourself” investors averaged

1.9% lower returns *per year* over that period and end up with 11% lower account balances. Think about the impact of 2% higher returns over the course of a working career. I provided an analysis in the book of the impact of saving 1% in fees and earning 2% higher returns over a 30-year period and it equated to a difference of nearly \$500,000. I describe the difference between using a professionally managed approach rather than a “do-it-yourself” approach as the choice between buying a car or building your own. We’ve found that most participants want to buy a car—in fact, when we are hired by companies to “build” cars within their plan, we usually experience anywhere from 70-100% of participants choosing this option rather than trying to assemble their own.

**Mi:** You wrote a lot about how, when it comes to saving for retirement, many investors have an unbalanced approach to investing that lacks diversification and discipline. This is a well known fact among financial industry professionals. Why do you think this is the case and how do you think the industry can help change this attitude?

**Ji:** The reasons for investors lacking diversification and discipline are many and varied. It could be debated for days as to all the reasons for this and I would guess the main underlying reason would be lack of knowledge and adding personal emotion to the equation when investing. As an industry, and for companies with 401(k) plans, we could improve this situation by forcing diversification through limiting options for plan choices to those that are well-diversified. Most companies think that more choice is better when providing investment options to participants. The reality is that giving participants too many investment choices has a negative impact, both on participation and performance. Most participants

know nothing about the options they are given and even less about how to construct and stick to a well-diversified portfolio. From a fiduciary standpoint, we're seeing the more progressive companies take steps to limiting the damage participants can do to themselves by poor investment selection and this involves rethinking the traditional way the menu of investment options are provided to participants. Few plan fiduciaries realize, that technically speaking, they probably are considered responsible for the individual investment decisions made by their participants.

**Mi:** You pointed out that clear and transparent fees are a major problem in the majority of current 401(k) plans. Because of this, employers may not be making good choices for their plan and employees may not be saving as much as they could be. Did the legislation you described from Congress and The Department of Labor that proposed regulations to better disclose fees go through?

**Ji:** Unfortunately the legislation did not go through in the form presented due to the new Administration entering the White House but it opened up the door for the process to be reintroduced and there are currently several proposals that are being reintroduced. I believe we most likely will see some sort of fee disclosure mandated within the next twelve months.

**Mi:** You stated that the total internal cost for many 401(k) plans is completely out of control. Do you believe it will take legislation/regulation, education or competitive market pressures to bring these costs down given the amount of money involved and the companies involved that benefit from these plans?

**Ji:** It's going to take a combination of all three. The regulation will force service providers to disclose

their compensation and conflicts of interest in an easily understood and meaningful way. As more and more companies become educated on what fees are charged for the services they are receiving then I think you will see the different players in the market be forced by competitive pressure to lower their fees and improve their levels of service to earn business. In my opinion, transparency and disclosure is the critical first step but it is not enough. Plan fiduciaries need to take the information they receive and make meaningful decisions with it, including negotiating with their

service providers. No one is willing to pay sticker price for a car but most companies pay sticker price for their 401(k) plan simply because they are unwilling to take the time to educate themselves and negotiate in a well-informed manner. If you don't know how much you're paying, how can you know if you're getting a good deal?

**Mi:** You favor passive management investments over active management investments for 401(k) plans. Do you favor these for all retirement investment strategies?





**JJ:** I prefer passively managed investments, such as index funds, for any portfolio of any size. They have lower cost structures, are generally more transparent and well diversified, and most importantly, have a strong tendency to outperform actively managed investments, especially as time progresses. If you take an honest look at the data you will find that the vast majority of active managers fail to outperform their comparable indexes, usually anywhere from 50-80% in any given year, and these percentages go up over longer periods of time. It is also nearly impossible to accurately predict which managers or funds will outperform ahead of time. Most people assume that if a manager has outperformed in the past they'll continue to do so in the

future but there's a reason you always hear the disclaimer "past performance does not guarantee future results." Past performance is actually one of the worst predictors of future performance. In fact, studies have shown that the most reliable predictor of future performance is fees—the lower the fees the higher the performance and vice-versa.

**Mi:** What advice would you give to our readership who are employees participating in a 401(k) plan and think it may be, as you call it, "broken"?

**JJ:** First, educate yourself and then be vocal to the people in your company who are responsible for the administration of your 401(k) plan. Ask them questions, give them articles, do your own research. At the same time, be respectful about how you approach things and realize that the company usually has the best intentions in mind when they set up a retirement plan. It's a very complex process and most "broken" plans we come across were not designed that way on purpose. But certainly you can ask questions about the plan and make sure you are as knowledgeable as you can be about the plan. My book is a helpful starting point and at the end of each chapter I include a number of questions plan fiduciaries should be asking themselves and their service providers in order to uncover problems and bring about clarity and accountability. The feedback I have received from readers is that this is the

most valuable aspect of the book and leads to some interesting discussions.

**Mi:** What is the one question our readers who are responsible for 401(k) plans should be asking themselves to ensure that they are providing the very best plan for their employees, while effectively protecting themselves?

**JJ:** I'd encourage them to ask whether they have implemented the *Fixing the 401(k)* approach which focuses on what we call the four "pillars" or key areas of fiduciary decision-making. First, has the plan been designed effectively so that employees are participating and increasing their contribution levels over time? Second, have steps been taken to fully identify all the fees within the plan, including who is receiving compensation and how much they are being paid, and have these fees been structured and negotiated to benefit the participants? Third, has the investment strategy for the plan been designed in a way that encourages and leads to successful investment experiences for participants? Finally, have the plan fiduciaries done everything in their power to understand and fulfill their legal duties and protect the interests of plan participants? Protection from personal liability comes from knowing what's required, implementing and following a prudent and consistent decision-making process, and relying on outside experts who really know what they are doing. The 401(k) is a major part of many American workers retirement plans and should be treated with the greatest care and respect. This responsibility lies solely with the people who are responsible for making the decisions about the plan, the fiduciaries.