



The Color of Money

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Let the 401(k) investor beware

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A new report from the Government Accountability Office warns employees to watch out for biased investment guidance from the financial companies paid to set up and run their 401(k) plans.

Although not a shocker, the GAO report nonetheless stings. People already skittish about the stock market are scared to put what savings they do have in a retirement account. No question many workers don't know what to do, so they turn to the companies running their retirement plan for help in selecting their 401(k) investments. But now comes this report that such assistance may not be in their best interest.

Really, how many more of these conflict-of-interest warnings can individual investors take before they just give up and put their retirement money into pitiful-paying savings accounts, which won't help them keep pace with inflation?

The Employee Retirement Income Security Act, or ERISA, says investment education is supposed to consist of general information, such as generic asset allocation models that are not tailored to a particular individual. But if an employee does get individual investment advice, it should be in that person's best interest and tailored to his or her particular needs. However, "in certain situations, participants face conflicts of interest from providers that have a financial interest when providing investment assistance," the GAO said.

The GAO, the investigative arm of Congress, says that the financial companies that manage 401(k) plans might not be fully disclosing to participants that they are receiving third-party payments from investment fund companies through deals sometimes called revenue sharing. These payments create a conflict of interest because providers get more money from certain funds. And for the less scrupulous, that's incentive to steer people to those funds even if they cost more or perform worse.

The GAO is also concerned about providers recommending higher-cost investment products outside of plans. For example, let's say a worker is leaving his company and wants to roll over his 401(k) money to an individual retirement account. The worker may not be aware, because of insufficient disclosures, that fees are often higher for products offered outside the plan. A service provider could earn \$6,000 to \$9,000 in fees from a participant's purchase of an IRA, compared with \$50 to \$100 in fees if the same participant were to invest in a fund within a plan, the GAO said.

"If left unchecked, conflicts of interest could lead plan sponsors or participants to select investment options with higher fees or mediocre performance, which, while beneficial to the service provider, could amount to a significant reduction in retirement savings over a worker's career," the GAO report said.

The GAO is recommending that the Labor Department require that service providers be clear about their compensation and potential conflicts of interest. The agency also has recommended that the Treasury Department require plan providers to disclose that investment products outside a plan could cost more.

If you invest in a 401(k), it's important that you understand the relationship between you, your employer and the provider who manages the retirement plan.

As the GAO explains, the providers charge fees for their services, which can include fund management (i.e., selecting and managing the securities included in a mutual fund), consulting and investment advice, record-keeping, custodial or trustee services for plan assets), and telephone or Web-based customer services for participants. Providers can offer affiliated services, including brokerage and money-management services. Some service providers operate as independent, "fee-only" advisers. This means they are compensated solely by their clients and don't get additional money based on the purchase or sale of a financial product.

Here's the problem, the GAO said: All these various streams of revenue going to plan providers are "often designed in a way that makes it difficult for conscientious plan sponsors to detect them."

In the past two decades, mutual funds have become a primary provider of 401(k) investments, with the share of 401(k) assets held in mutual funds jumping from 9 percent in 1990 to 55 percent at the end of 2009, according to the Investment Company Institute. By the end of 2009, 401(k) plans held \$2.8 trillion in assets.

In 2008, about 49.8 million workers actively participated in a 401(k) plan, representing about 17 percent of the \$14 trillion U.S. retirement market. In 1990, by comparison, these figures were \$385 billion in assets and 10 percent of the market.

By no means should the GAO report cause you to stop investing in your 401(k) or dissuade you from seeking help from the provider in figuring out how to allocate your contributions. But it is yet another infuriating reminder that investors need more protection.

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