Why Financial Advisors Should Offer Investment Education to 401(k) Plan Participants

By Ary Rosenbaum, Esq.

One of the major cornerstones of our society is public education. Regardless of race, religion, creed, gender, income, or national origin, children from kindergarten through the twelfth grade are entitled to a free education because our society valued educations Education helps individuals to attain intellectual, physical and spiritual or emotional progress. Public education offers no guarantees, but it can offer a lot of opportunities for individuals to progress as human beings. The same thing can be said of offering investment education to plan participants.

When it comes to being a retirement plan financial advisor, too many advisors concentrate on the concepts that aren't as important as they seem, such as picking out mutual funds or making cute brochures. The most important role a financial advisor has in working with a retirement plan is minimizing the fiduciary liability that a plan sponsor and the plan trustees have when handling the process of plan investments. So while much has been written about the needs of developing an investment policy statement (IPS) and reviewing the plan investments based on that IPS, very little attention is paid to the role of providing education to participants when the investments under the Plan are directed by these participants.

Advisors ask me all the time of the role of education in participant directed 401(k) plans. Participant directed 401(k) plans that are governed under ERISA §404(c) offer the plan sponsors liability protection based on a participant's gains or losses on their account when they direct their own investment. Participant education can be used as a tool to help plan sponsors minimize their liability under §404(c).

One of the biggest misconceptions out there about the role of participant education under Section 404(c) plans is that it's not required. There is nothing in the statute or in the regulations that actually requires the plan sponsor and/or the plan's financial advisor to offer education to participants. However, under Department of Labor regulations issued under ERISA §404(c), in order for plan participants to exercise control for purposes of making it a participant directed plan, the fiduciaries must provide sufficient information to participants so that they can make informed decisions. The sufficient information is information such as a description of the investment alternatives available under the plan, including a general description of the investment objectives and risk and return characteristics of each alternative (including type and diversification of assets in the portfolio of the alternative); identification of any designated investment managers; an explanation of how to give investment instructions, and a description of any transaction fees or expenses charged to the participant's account (e.g., commissions, sales load, deferred sales charges, and redemption or exchange fees). The problem is that this information doesn't actually provide sufficient information to participants so that they can make informed decisions. In addition, studies have shown that investment education does provide participants a better rate of return for those who received education than participants who didn't. So to minimize liability and to increase the rate of return for plan participants, an advisor should make sure that investment education is offered to the plans they service.

What type of investment education should advisors offer to plan participants? Well obviously, it has to be education and not actual investment advice. The Department of Labor in Interpretive Bulletin 96–1 delineated four categories of investment information that do not constitute investment advice under ERISA. The four categories include plan information such as information about plan participation and the investments offered under the plan; general financial and investment concepts such as risk, diversification, and asset classes; asset allocation; and interactive investment materials such as estimating future retirement income needs. Handing out a bunch of Morningstar profiles and wishing everyone good luck isn't sufficient education. Financial advisors will have to be more proactive than that.

I have met too many financial advisors that aren't interested in offering education or are afraid to. While offering education to plan participants can help a plan sponsor minimize liability, it is also an effective tool for financial advisors to market their business. There are too many financial advisors who don't offer education to their plan sponsor clients and they are at a certain disadvantage to those that do. I believe that financial advisors that say no to offering education to plan participants will be replaced by those who do. I had a client who fired their broker after I informed them that he was getting paid too much (60 basis points on a $14 million plan) and was not offering education to plan participants. The client immediately fired the broker and replaced him with a financial advisor willing to take on that role.

Advisors also shy away from offering participant education because they really don't understand what it's really there for. Like public education, offering participant education is not offered to achieve a certain result. Advisors should always look at education as liability protection, because offering participant education help a plan sponsor minimize their liability under ERISA §404(c). While I always stress education as important part of the fiduciary process, it's not about achieving a specific result from participants directing their own investments. Offering participants educations is like the old proverb, "You can lead a horse to water, but you can't make him drink." So no matter how great the education component is, there is no guarantee that it will help plan participants achieve a better financial result because like they say, there is no guarantee in life, except maybe death and taxes. The participant who put all his money into a mid-cap fund because he considers it the "average of the market" may still do so even after getting education at the enrollment meeting and through a one on one meeting. As with most things with retirement plans, it's about following a process and not guaranteeing a result. You are not trying to teach an MBA course, you just need to provide sufficient information so that plan participants can make decisions that are informed and not based on the economic theory of "Eeny, meeny, miny, moe".

A recent study showed that plan participants who used the investment help (which does also include target date funds) offered under their plan experienced annual returns nearly 3 percent higher (292 basis points, net of fees) than those individuals managing their 401(k) accounts on their own. While some would scoff that the difference is only 3% that 3% is annual which over 20 to 40 years is quite a bit of shekels and dollars. So while it is certainly a positive development that those who get help do better, it should be noted that only 30% of plan participants use the help offered in their plan. So 70% of plan participants go it alone. If a financial advisor is seriously interested in helping 401(k) plan participants as part of their job working with plan sponsors, they have to offer some form of participant education.

Even if an advisor is not confident in their abilities to provide education or just don't want to bother, they have an opportunity to hire someone who will. Companies like my friends Sean Ruehl and Chip Jurgensen at rj20.com can handle on-line participant education as well as offering participant advice. Same with the folks at Smart401k.com and other companies who can provide on-line education and advice. Why reinvent the wheel if you don't want to drive? Especially when folks like rj20 and Smart 401(k) can do it for you.

While advisors state that participants aren't interested in education meetings and one on one participant meetings, I really don't believe that most advisors do a very good job of it. A plan education/enrollment meeting doesn't have to be treated as jury duty or a wake; financial advisors would be wise to add some interest by spicing up these meetings. While the information can be boring for most, advisors can entice attendance by bringing in food because like I always say, free food goes a long way. In addition, an advisor could offer a raffle for a simple $25 gift card for attendees, it's these small inexpensive gestures that will spur attendance and spur interest in your job. You can also try to inject humor into the process; no one would be reading my articles if they were a dry look at retirement plan issues. Breaking down important financial concepts into English with a little wit can go a long way. Happy plan participants will help you maintain your role as an advisor for your plan. So while people won't remember what mutual funds are offered under their plan, they may remember that Donna in accounting won the Target gift card. Anything that can boost attendance will help boost education and better results for plan participants, as well as helping limit the plan sponsor's potential fiduciary liability.

Offering plan education is a facet of the fiduciary process that all financial advisors should assist in, because helping a plan sponsor in that process is the role of a retirement plan financial advisor. Not offering education allows the advisor's competition a competitive advantage by highlighting that the incumbent advisor isn't covering all the bases in protecting the plan sponsor's exposure as a plan fiduciary. A plan sponsor who thinks their advisors isn't handling all the tasks that they are supposed to is often the same plan sponsor looking for a new financial advisor to work with.

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