Even Harsh Frontline Program on Retirement Investments Understates How Bad They Are

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Wall Street must get indigestion every time Frontline rolls out another program showing the depths of its chicanery. The only problem is the industry deserves much worse punishment.

The latest report, **The Retirement Gamble**, focuses on the scams in the retirement industry, the retail brokers and asset managers who sell products to 401 (k)s and other tax exempt plans. Anyone who knows this arena will find that the report covers familiar terrain. But the appalling fact remains that ordinary Americans who don't have the time or interest to be full time investors but want to take prudent steps to prepare for retirement are systematically fleeced by the industry. And due to the time limits and complexity of the terrain, the program can hit only on some important issues.

Watch **The Retirement Gamble** on PBS. See more from **FRONTLINE.**

The biggest, and the one that is the main focus of the report, is that the fees in 401 (k)s are not disclosed in any easy-to-understand manner, so participants are buying a pig in the poke. Moreover, fees are indefensibly high, in large measure because the firms push actively managed products when passive strategies (index funds) deliver the same or better returns as much lower cost, making a huge difference in the amount investors realize. Comparatively few brokers and financial advisors are fiduciaries; many are on commission or get kickbacks or other incentives for selling high-fee products.

Some of the quotes are devastating:

Prof. TERESA GHILARDUCCI, Economist, The New School: The 401(k) is one of the only products that Americans buy that they don't know the price of it. It's also one of the products that Americans buy that they don't even know its quality. It's one of the products that Americans buy that they don't know its danger. And it's because the industry, the mutual fund industry, have been able to protect themselves against regulation that would expose the danger and price of their products.

And the impact of fees is larger than you might think:

JOHN BOGLE, CEO, The Vanguard Group, 1974-96: Costs are a crucial part of the equation. It doesn't take a genius to know that the bigger the profit of the management company, the smaller the profit that investors get. The money managers always want more, and that's natural enough in most businesses, but it's not right for this business.

MARTIN SMITH: Bogle gave me an example. Assume you're invested in a fund that is earning a gross annual return of 7 percent. They charge you a 2 percent annual fee. Over 50 years, the difference between your net of 5 percent — the red line — and what you would have made without fees — the green line — is staggering.

Bogle says you've lost almost two thirds of what you would have had.

JOHN BOGLE: What happens in the fund business is the magic of compound returns is overwhelmed by the tyranny of compounding costs. It's a mathematical fact. There's no getting around it. The fact that we don't look at it— too bad for us.

MARTIN SMITH: [on camera] What I have a hard time understanding is that 2 percent fee that I might pay to an actively managed mutual fund is going to really have a great impact on my future retirement savings.

JOHN BOGLE: Well, you have to rely on somebody to get out a compound interest table and look at the impact over an investment lifetime. Do you really want to invest in a system where you put up 100 percent of the capital, you the mutual fund shareholder, you take 100 percent of the risk and you get 30 percent of the return?

Boogle's assumptions are actually charitable. Remember, the fees come out of the account regardless of whether the investment performs. There have been entire decades (the 70s and the decade just past) where stock market returns went sideways. Moreover, that 2% is simply a typical figure. Some products often feature even higher levels of gouging. For instance, Smith interviews an investor who got into an annuity with high annual charges and a 10% exit fee.

And there are even more problems with 401 (k)s that Frontline didn't address. For instance, most plans let you switch funds only once a year. It's not uncommon for them to take two to six weeks to credit the money they've taken out of one fund to another. And the choice of funds is often limited and poor (for instance, duplicative offerings, such as separate stock and bond funds and then a balanced fund; too many sector plays; not enough asset classes, meaning no international stock and bond funds; often no REITs or real estate funds).

If you don't have time to watch the entire program, you should at least have a look at how unsavory the executives in the industry are. Some of Mrs G's faves include 27:22, when Smith asks Michael Falcon at JP Morgan to respond to Jack Bogle's statement (a fact) that actively managed fund fees eat two thirds of returns over a 50 year horizon. At 36:16, he tries to defend the role of active managers. And at 47:45, he tries telling Smith that investors lose…something…if their advisor does not have a fiduciary duty to his customer.

But he comes off as a typical jock turned retail broker who successfully feigns being a bit at sea when challenged on the basic problems with how he operates. That's actually a step up from the dripping with contempt Karen Wimbish of Well Fargo. She's at 32:37. The transcript below doesn't do her performance justice, I strongly suggest you watch this bit if nothing else.

MARTIN SMITH: The problem is that these fees are not paid by the fund company. The bill is passed to you and me. Here it is, buried deep in my 401(k) plan documents. It took me about an hour to find the reference.

[on camera] Do you think the industry could do a better job of making people aware of the effective fees on their savings?

KAREN WIMBISH, Retirement Executive, Wells Fargo: I think we could make people aware of the effect of every pressure that they have on their accounts.

MARTIN SMITH: What stands in the way of doing that better job?

KAREN WIMBISH: [laughs] I— what I would tell you is, it's— sometimes, it's very difficult to get people to focus on something that seems complicated and dull and boring. So could we do a better job with helping consumers understand all the things that are tied to what they just bought, whether it's financial services or the riding lawn mower? Yes. It's too complicated.

Translation: Consumers are too lazy to understand this stuff, so asking us to explain our charges to them is a waste of our precious time and resources. Of course, this is patently ridiculous. Fees are simple to comprehend; it's all the deliberately obfuscatory language that gets in the way.

There are two things I wish the program had been able to address. One is that they had several anecdotes at the beginning of investors who were long equities, thought they were making money, and gave much or all of it up in downturns. Benoit Mandelbrot stressed in his layperson-friendly version of his research on markets, The (Mis)Behavior of Markets, that standard investing theories (the stuff MBAs and finance "experts" learn) lead them to take on much more risk than they intended. So even supposedly educated investors adhering to received wisdom do more gambling than they intend to, particularly over-allocating to stocks.

Second that short job tenures and income instability make it hard for even prudent people to adhere to a financial plan. Martin Smith even confesses he's had to raid his retirement accounts more than once to pay for a divorce and help put his kids through college. This is something Helaine Olen presents persuasively in her new book **Pound Foolish: Exposing the Dark Side of the Personal Finance Industry**, and I wish the producers had included those impediments in this account.

And that leads to a final issue: the big reason so many Americans are coming up short as far as retirement is concerned is that worker wages have stagnated, thanks to companies no longer sharing the benefits of productivity gains with employees as was once the norm. We wouldn't be having a debate about possible future Social Security shortfalls if wage gains hadn't tailed off as a result of 30 years of policies oriented towards weakening the bargaining power of labor. But you'll never hear that from the finger-wagging 1%: if you'd only been more frugal and responsible, you'd have an adequate retirement. For the lucky few that have no periods of unemployment, no divorce, no medical emergencies, no sick parents who need time and financial support, that might be the case. But those of us who live in a world whose instability is in no small measure due to rent-seeking by those at the top of the food chain know better.