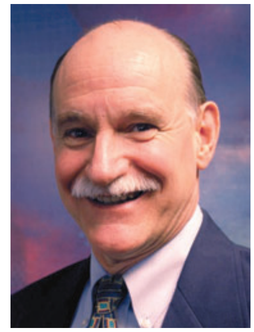
President's Page



Why 401(k) Success?

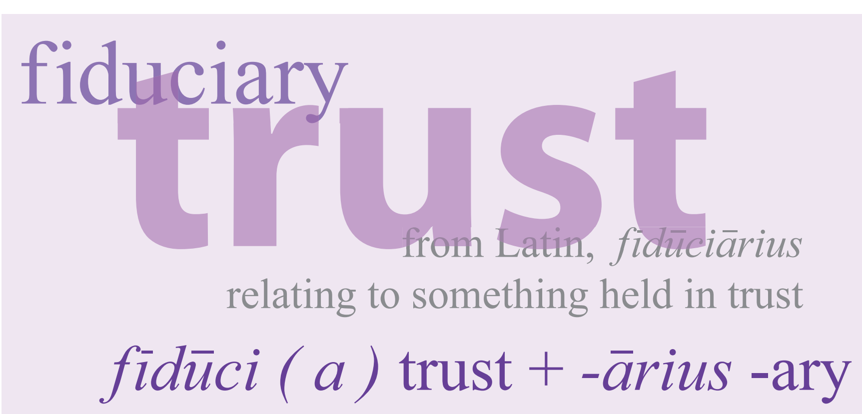
Its trustworthy employers.

By David Wray

Trust is critical in the 401(k) system. In a defined contribution plan, workers give up income today in anticipation of future retirement benefits. This requires that workers trust their employer to transfer their withheld wages to financial professionals who will manage their money not just effectively but ethically, for decades. (Remember, the root of the word fiduciary comes from the Latin words, *fiduciarius* of something held in trust, equiv. to *fiduci (a)* trust + *-arius* -ary.) Younger workers who have the longest time horizons need to be the most trusting.

In an environment where Americans' trust in experts and institutions has been compromised, in part because of the near crash of our financial system and when money managers stealing their clients' money, like Bernard L. Madoff, seemed routine, workers have every reason to stop saving in their 401(k). However, most workers continue to trust their employers. In the EBRI *1993–2010 Retirement Confidence Survey*, 77 percent of workers were either very confident or somewhat confident in employers. Contrast this with the 55 percent of workers who were very confident or somewhat confident in the Federal Government.

The importance of that trust applies to the acceptability of how 401(k) investments are invested as well. I remember being told when I graduated from high school that I should only invest money in the stock market that I could afford to lose. Fear of loss coupled with suspicion about financial markets continues to be a barrier to successful long-term investing. These concerns have been exacerbated by recent events. The result has been a massive movement from equities to fixed income by retail investors and the price of gold rising every day. Because they trust their employers, only in employer defined-contribution plans have savers stayed the course.



In their book, *Nudge*, Dick Thaler and Cass Sunstein suggest that people should be "nudged" into better decision-making by selecting benevolent choices as default options. When these defaults are thoughtfully selected, they can help increase savings levels in defined contribution plans and the asset allocation of plan investments.

However, if participants do not trust decision makers, they will be much less willing to accept defaults. In another study, Professors Liersch and McKenzie show that when people feel deceived, they not only ignore defaults, they reject them. People are less likely to accept a recommendation from someone they do not trust, and once trust is lost, it is hard to regain.

Today, American employers occupy a special place. They are trusted by their employees. As Jodi DiCenzo said at PSCA's recent National Conference, "While participant confidence has been shaken, shockingly high percentages of employees appreciate and value the many benefits of the 401(k) system." It is important we all understand that it is employers combining the best interest of their employees and their organizations who are responsible for the remarkable stability of the 401(k) system since 2007.

David Wray is PSCA's president.