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**House Committee on Education and Labor
Honorable George Miller, Chairman**

**“The Impact of the Financial Crisis on Workers’ Retirement
Security”**

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Good morning Mr. Chairman and members of the Committee. Thank you for the opportunity to speak with you today. My name is Mark A. Davis and I am a principal in Kravitz Davis Sansone, Inc. a registered investment advisor that is part of the Kravitz organization. Kravitz is the largest independent pension design, consulting and management firm headquartered in California. All we do is service qualified plans, their sponsors and participants. Kravitz administers more than 1,000 plans, mostly of smaller employers, and we serve as fiduciary advisor or investment manager on more than 180 plans of all sizes. We also have a team that spends a great deal of time providing employee meeting and investment education services primarily to smaller companies. I am an independent investment advisor, and in that capacity I do not receive any compensation without the contractual approval of plan sponsors—in most cases I am paid by the plan sponsor or the plan at the direction of the sponsor.

I want to start by adding my voice to those that have expressed appreciation to the hard work done by this Committee on retirement security issues, particularly in regards to fee disclosure. As we sit here today in the third week of a new calendar quarter, American workers are beginning to receive their retirement plan statements for the period ending September 30. It is unfortunate that millions of those plan participants will be receiving statements that do not disclose the fees that they are being charged. It is all the more disturbing in the current performance environment—participants pay those same hidden fees regardless of market losses. The sunshine of better disclosure is badly needed—and thank you for your continued efforts.

The private retirement system, flaws and all, has been a huge success in helping Americans build real wealth for retirement and to pass that wealth on to future generations. This includes not just 401(k) plans but also 403(b) and 457 plans as well that are used in the public sector. Every day we see Americans who are benefiting from the savings discipline that these plans impose. Even with the market turmoil my team tells me that for every person raising concerns about their balances there are many others vocal in their determination to stay with the program in order to maximize their long-term opportunities to build their retirement nest-eggs. On Friday of last week I met with three different groups of employees at a manufacturing firm in Texas. The first two meetings were for shift workers, one group coming on and one group going off, most of whom spoke Spanish as their primary language. While clearly concerned with the economy, these men were unified in their enthusiasm for their 401(k) plan and the Profit Sharing

contributions their employer provides. I have served this Plan since 2000 and I have come to have a warm relationship with many of these gentlemen, despite the language and cultural divide that separates us. They now have the experience to know that we got through the last downturn and we will get through this one too. For these workers the plan is a highly valuable means of saving for retirement and of sharing in the success of their company. For many it is their first and only means of saving and building a stake in the system.

It is exciting to note how different the services participants have available to them during this downturn are. When the last bubble burst and the market fell from 2000 to 2002 we did not have as many tools to help as we do now. Very few plans had the chance to use diversified tools like target maturity funds. Automatic enrollment and Qualified Default Investment Alternative protocols were not yet prevalent. Advice and managed account tools had very little market penetration. During those years people in my profession did the hard work of comforting and educating employees, encouraging them to “stay the course” and keep contributing, assuring them that some day the market would actually go up again. Those participants saw significant and real gains during the bull market run from 2003 through 2007. While this recovery, whenever it comes, won’t happen in the same way or on the same timeline, long term it will have the same effect.

Let me give you some more examples of what we are seeing and experiencing today. My associates and I have met or communicated by phone or email with scores of participants in the past few weeks.

You have heard statistics concerning the increase in applications for loans as well as hardship and other in-service distributions. Our team that processes loans and withdrawals for the clients we serve, who are again, primarily small businesses, has seen a moderate increase in the number of loans requested over the last year and a significant increase in requests for hardship withdrawals during that same period.

Last week a company whose education services are provided by a large financial institution received a call from an irate participant accusing them of having “taken \$10,000 out of his account”. My client explained that the drop was due to market losses and made it clear that the participant was not experiencing anything that was unique to him. This participant simply did not understand that the value of his retirement account could go down.

A 52 year old employee of a Texas retailer told me he couldn’t stand the volatility in his plan anymore and he wanted to take what was left of his money out to “pay off his house” so his family would have somewhere to live when he got fired. I did the best I could to give him the pro’s and con’s of such a move, but in the end he was determined to find a way to get at the money even though he would have to pay a 10 percent penalty tax on top of income tax.

I spent time on the phone with an attorney who was irate that his ability to trade his account had been limited by his financial institution vendor, a practice put in place in

2004 in response to regulatory pressures stemming from the mutual fund trading scandals earlier this decade.

There are times when the business of conducting employee education meetings is truly rewarding. Helping people to understand and maximize their opportunities for retirement savings success is a mission for many of us in the field. For most working Americans, the closest they will ever get to professional investment advice are the encounters they have with investment educators, either independents, like us, or employees of their primary retirement services vendors. There are also times when it can be very challenging counseling participants, particularly older ones, who have experienced sometimes significant investment losses. But make no mistake. Investment sophistication has no correlation to the color of the collar. Many blue-collar Americans are no more at sea than many of their white-collar counterparts. There is a huge need to educate all Americans, from their early years, on the basics of financial education, from retirement savings to mortgage rates. That education cannot be left to the private sector.

Automatic enrollment has also spawned a new and potentially culture changing waive of co-opted participation among employee and people groups that have been unintentionally “carved out” by prior positive enrollment protocols. Unfortunately many of these new automatic enrollment programs have just been put in place in this year. The result is that many first time participants have been brought into the system and invested in diversified portfolios, most frequently age based target maturity funds, and have experienced unprecedented downdrafts in the last few months. Some of these people feel distraught

and some even betrayed. Our challenge now is to keep those people engaged and committed long enough for them to benefit from the long term return of market stability and success. More education is called for.

Plan sponsors are faced with unique challenges that are evolving even as we sit here today. The recent volatility has forced several plans we serve to put much needed changes on hold as Human Resources staffs have balked at making changes that might scare employees. Making plan level investment menu changes has also been made much more difficult and needlessly complex by the inconsistent enforcement of short-term redemption fee policies resulting from the trading scandals earlier this decade. Every mutual fund company and financial institution has its own rules and they are not enforced consistently. Both sponsors and participants are intimidated and confused by the inconsistencies.

Many plan sponsors, particularly in the small plan area of the marketplace, use annuity products from insurance companies as the vehicle for their retirement plans. These products generally offer a broad array of investment choices, managed by multiple, diverse investment managers, from which the sponsor can select an investment menu to offer participants. They have evolved greatly over the years and when used properly can offer an excellent means for providing a retirement benefit program. Often, though, they come with a “catch”. The only alternative some of these products make available for the most risk averse participants are quote “guaranteed” accounts. In many if not most cases we have seen these consist of investments in the General Accounts of the sponsoring

insurance company. Many times a plan sponsor or participant's ability to withdraw from these accounts is severely constrained in return for the perceived value of the "guarantee". It is our understanding that, in the event of a failure of an insurer, these accounts would have only marginal preference over other creditors in the event of insolvency of the insurer.

We have seen plans with 60-70% of their assets invested in such vehicles. While on an absolute return basis they may look good this year, no one would argue that investing 60-70% of a plan's assets in a bond of that one insurer, or the stock of that one insurer, or any one company for that matter, would be prudent. Yet that is exactly what many plans are doing. We know from brutal experience that most participants who use these investments have no idea of the risks to which they are truly exposed. They believe the word "guarantee". In these days of volatility, much money is pouring in to these accounts at the exact time that many insurers are under the most extreme pressure. It is critically important that just as participants need to diversify their investments, plan sponsors need to offer diversified investment choices. As far as I know, the Department of Labor has not focused on this.

If I may I would like to take a moment to offer you my thoughts regarding the current status of investment education in the retirement system. When I began my career in 1991, I joined the "Employee Communications" department of a major financial services firm. Within a year the department's name, and function, was radically changed. Over night we became the "Investment Education" department as that became a sales

differentiator in the marketplace. Our new function was to teach people how to use the investments that we offered, under the name and restrictions of “guidance” not “investment advice”. Throughout the decade of the 1990’s, as defined benefit plans gave way to defined contribution plans as a society we shifted the burden for retirement funding and investing from sponsors to participants. We did so without any corresponding emphasis on education. We relied on the private sector to provide educational services. The private sector cannot be blamed for doing what is in its own best interests, creating better future clients for itself. It is not in the financial interest of most vendors to spend much time educating the great bulk of American participants, most of whom will never be future clients for most of those firms.

We have seen this all too clearly with several clients. One client, whose business involves a large number of non-highly compensated employees who do physical labor, has a high percentage of employees for whom English is not their primary language. Our client offers a very generous employee matching contribution which very few of their non-highly compensated employees were taking good advantage of. When the client changed vendors and added an automatic enrollment protocol, they met with participants in one on one sessions in the language of their choice, and were able to get employees to truly embrace the program. In retrospect many of the employees had not really understood the plan and felt it wasn’t for them. The pictures and images in all of the enrollment materials used by their prior vendor depicted employees and smiling retirees who were not culturally representative of the broader range of our client’s employees.

The plan looked and felt like a benefit for management even though it really is an excellent benefit for all employees.

I want to strongly encourage future efforts at cooperation between the Departments of Labor and Education. If Americans are to be given the responsibility to manage their own retirement investments as a means of lessening the liability of both employers and society, then students from Kindergarten through 12th grade should be taught basic financial principles as a means of getting ready. We still teach Trigonometry, but most Americans graduate high school without knowing the importance of savings, or how credit cards, car loans, and mortgages work. Proper long term education, across cultural lines, will make future generations of Americans hungry for and prepared to handle the retirement plans their future employers will offer.

The current volatility, and the damage it has done, cannot be undone in the near term. Steps like a temporary repeal of minimum required distribution rules may help to alleviate some of the worst pain. You may also want to consider temporarily encouraging all plans to offer hardship withdrawal provisions to prevent foreclosure and eviction. Other steps that encourage more diversified stable value investing and discourage the use of general account products for ERISA assets will also help. If this Committee can help to clarify and make more consistent the rules that govern short term redemption fees and transaction limitations that will remove a major cause of unnecessary plan complexity. Most importantly if you can charge the Departments of Labor and Education to work together to better educate future American workers some of

the anxiety and panic being experienced today may be avoided in response to future market turmoil.

Thank you for your time. I will be pleased to answer any questions that I can.