PENSIONS AND RISK AVERSION: THE INFLUENCE OF RACE, ETHNICITY, AND CLASS ON INVESTOR BEHAVIOR

by
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Defined contribution plans have greatly expanded over the last two decades. Defined contribution plans place the investment risk on employees. Employee investment decision making should be examined to determine whether those decisions are influenced by race, ethnicity and/or class.

Empirical data show that investor behavior is greatly influenced by race, ethnicity and/or class. Blacks and Hispanics are far less likely to invest in the stock market than whites. Low income whites are far more likely to invest in the stock market than higher income blacks or Hispanics. As a result, retirement account balances are the greatest for many white households and the least for black, Hispanic, and certain white households. This Article explores those issues and suggests solutions that will allow employees to overcome their built-in biases and make wiser investment choices.

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I. INTRODUCTION

My prior scholarship has addressed the race, gender, and class implications of federal tax policy.[1] This Article's focus is on employer-provided pension plans.[2] Defined contribution pension plans are increasingly becoming the norm in the American workplace.[3] Defined contribution plans place the investment risk on the employee, whereas defined benefit plans place the investment risk on the employer.[4] Employee investment decision making will therefore significantly affect their account balances at retirement. Employee decision making, however, is influenced by race, ethnicity, and class.

This Article suggests that if the goal for retirement is for all employees to have an equal opportunity for a financially secure retirement regardless of race, ethnicity, or class, then employees will have to change their behavior—as will employers. This Article suggests several changes which, if implemented, could increase the likelihood of financial security for all workers.

Part II begins by describing the tax advantages associated with employer provided pension plans. It then briefly describes the dramatic shift in pensions from defined benefit to defined contribution plans and the corresponding shift away from employers bearing the investment risk (defined benefit plans) to employees bearing the investment risk (defined contribution plans). This

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[1] *See, e.g.*, Dorothy A. Brown, *Race and Class Matters in Tax Policy*, 107 COLUM. L. REV. 790 (2007); *The Tax Treatment of Children: Separate But Unequal*, 54 EMORY L. J. 755 (2005); *Social Security and Marriage in Black and White*, 65 OHIO ST. L. J. 111 (2004); *Race, Class, and Gender Essentialism in Tax Literature: The Joint Return*, 54 WASH. & LEE L. REV. 1469 (1997).

[2] I have previously written about this subject, but primarily through a race-based focus. *See* Dorothy A. Brown, *Pensions, Risk, and Race*, 61 WASH. & LEE L. REV. 1501 (2004). This Article expands upon many of the themes I briefly touched upon earlier.

[3] This symposium, for example, is premised upon this fact. *See* Symposium, The Aging of the Baby Boomers and America's Changing Retirement System, 11 LEWIS & CLARK L. REV. 267 (2007). *See also* Susan J. Stabile, *The Behavior of Defined Contribution Plan Participants*, 77 N.Y.U. L. REV. 71, 74 (2002) ("[D]efined contribution plans, specifically 401(k) plans, are the primary vehicle for providing retirement income today."); Katherine V. W. Stone, *Legal Regulation of the Changing [Employment] Contract*, 13 CORNELL J. L. & PUB. POL'Y 563, 578 (2004) ("[E]mployers are restructuring their benefit plans just as they are restructuring their employment practices. In keeping with the ethos of the new workplace, the new benefit plans embody a retreat from the principle of risk-sharing and an adoption of a principle of individual choice. The new plans, such as defined contribution plans for pensions and health savings accounts, shift more risk of uncertainty onto employees, thereby weakening the social safety net.").

[4] *See* Brown, *supra* note 2, at 1509–10 ("Defined contribution plans, on the other hand, are those that pay out whatever is left in the account at retirement, such as 401(k) plans. In these plans, employees are responsible for making the investment decisions for their contributions to the plan.") (citations omitted).

Article takes this shift as a given and a trend that will continue in the future, and does not explore the reasons for the shift.[5]

Part III provides empirical data concerning the investment behavior of employees by race, ethnicity, and class.[6] While it is commonly known that most employees don't make good investment choices,[7] including over-investing in employer stock,[8] this section points out the additional challenges facing racial and ethnic minorities and low income employees generally.

Part IV describes employee biases that are revealed in their investment decisions. Part V suggests solutions which are designed to eliminate retirement account balance disparities based upon race, ethnicity or class.

II. DEFINED CONTRIBUTION PLANS

Employer-provided pension plans that meet certain requirements receive tax advantages.[9] For fiscal year 2006, the estimated loss in tax revenue as a result of all qualified pension plans (including earnings) is $124.7 billion, which makes it the largest tax benefit available for individuals.[10] By comparison, the estimated revenue loss for the mortgage interest deduction is $69.4 billion and $92.2 billion for the reduced rate on dividends and long-term capital gains.[11]

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[5] *See e.g.*, Susan J. Stabile, *Paternalism Isn't Always a Dirty Word: Can the Law Better Protect Defined Contribution Plan Participants*?, 5 EMP. RTS. & EMP. POL'Y J. 491, 493–98 (2001).

[6] This paper expands upon my prior empirical analysis of employee participation and investment decisions. Brown, *supra* note 2, at 1530–38.

[7] *See e.g.*, Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1521 (1997) ("[F]or reasons rational and irrational, employees have not invested [in defined contribution plans] so as to best capture the equity appreciation associated with the New Economic Order."); Jeffrey N. Gordon, *Individual Responsibility for the Investment of Retirement Savings: A Cautionary View*, 64 BROOK. L. REV. 1037, 1037–38 (1998) ("Individuals are not good risk bearers of market volatility, both in a financial sense and in a psychological sense. . . . The evidence from current investment of 401(k) plans and other self-directed regiment plans is that individuals tend to underweight equity and correspondingly overweight fixed-income securities despite long-term horizons of retirement savings."); Stabile, *supra* note 3, at 88 ("Study findings reveal that substantial numbers of plan participants are financially illiterate, including a lack of knowledge and understanding of financial concepts and common financial instruments as well as inadequate 'general knowledge regarding retirement planning and savings issues.'").

[8] *See* David Millon, *Worker Ownership Through 401(K) Retirement Plans: Enron's Cautionary Tale*, 76 ST. JOHN'S L. REV. 835, 841 (2002). *See also* Susan J. Stabile, *Is it Time to Admit the Failure of an Employer-Based Pension System?*, 11 LEWIS & CLARK L. REV. 305, 313–14 (2007).

[9] *See infra* notes 12–15 (describing the tax benefits associated with pension plans).

[10] THOMAS L. HUNGERFORD, CONG. RESEARCH SERV., TAX EXPENDITURES: TRENDS AND CRITIQUES (2006), *available at* http://www.opencrs.com/rpts/RL33641_20060913.pdf.

[11] *Id.*

The tax benefits are significant. First, employers immediately get to deduct payments made to trusts established for the pension funds.[12] Second, employees get to exclude from their income payments that they make or that their employer makes on their behalf to the trusts.[13] Third, the income that the trust accumulates is not taxed.[14] Fourth, it is only when employees make a withdrawal from their pension plan that they will be taxed.[15]

Defined contribution plans have increased exponentially over the last two decades, while the overall percentage participating in any plan has declined.[16] In 1985, 91% of all employees participated in retirement plans, with 80% of employees participating in a defined benefit plan and 41% in a defined contribution plan.[17] In 2000, 70% of all employees were in a retirement plan, 36% in a defined benefit plan and 50% in a defined contribution plan.[18] In 2003

[12] *See* I.R.C. §§ 404(a)(1)–(3) (2000) (listing the types of plans for which the employer can deduct contributions); JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 222 (3d ed. 2000) (stating that employers can deduct payments to the trust).

[13] *See* I.R.C. § 402(a) (2000) (stating that distributions from an employee's trust are taxed in the year they are distributed).

[14] LANGBEIN & WOLK, *supra* note 12, at 222 (stating that a trust is exempt from tax on its investment income). The employer does not have to establish a trust. The employer can purchase an annuity plan and receive the same tax treatment, provided the annuity plan satisfies the provisions of § 404(a)(2) of the Internal Revenue Code. *See* LANGBEIN & WOLK, *supra* note 12, at 222 ("Annuity plans, which purchase annuities directly and do not have a trust, must meet essentially all of the requirements of IRC § 401(a) and are taxed in an identical fashion."). The balance of this Article should be taken to include annuity plans when qualified plans are discussed.

[15] *See* I.R.C. § 402(a) (stating that distributions from the employees' plan are taxed when they are distributed); LANGBEIN & WOLK, *supra* note 12, at 222 (noting that employees are taxed when they make withdrawals from their pension plans). If employees don't make withdrawals by a certain age, they will be deemed to have made the withdrawal. *See* I.R.C. § 401(a)(9)(C)(i) (2000) (stating that the required beginning date is April 1 of the year the employee would have reached 70.5 years old or of the year in which the employee retires); LANGBEIN & WOLK, *supra* note 12, at 426 ("The required beginning date is generally April 1 of the calendar year following the later of the calendar year in which the employee attains age 70 ½, or the calendar year in which the employee retires.").

[16] Jay A. Soled & Bruce A. Wolk, *The Minimum Distribution Rules and Their Critical Role in Controlling the Floodgates of Qualified Plan Wealth*, 2000 BYU L. REV. 587, 591 ("Over the past two decades, defined contribution plans (including IRAs) have evolved to be the qualified plan of choice, eclipsing the once dominant role of defined benefit plans."); Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 8 (2000) ("By all these measures, the growth of 401(k) plans has been dramatic."); Regina T. Jefferson, *Striking a Balance in the Cash Balance Plan Debate*, 49 BUFF. L. REV. 513, 514 (2001) ("The composition of the private pension system has changed significantly since the passage of the Employee Retirement Income Security Act (ERISA) of 1974. When ERISA was enacted, traditional defined benefit plans were the most common type of retirement plan, and defined contribution plans primarily were used as supplemental savings arrangements. Recently, however, employers have increasingly established defined contribution plans as primary retirement savings vehicles.") (citations omitted).

[17] Bryandt Rose Dickerson, Bureau of Labor Statistics, Employee Participation in Defined Benefit and Defined Contribution Plans, 1985–2000 (June 16, 2004), *available at* http://www.bls.gov/opub/cwc/cm20030325tb01.htm.

[18] *Id.*

the primary retirement plan was a defined contribution plan, with 57.7% of participants identifying this as their most important plan.[19]

Department of Labor statistics show that assets held in 401(k) plans grew at an annual rate of 23%, which is a faster growth rate than any other type of pension plan.[20] Defined contribution plans are now the most common type of employer-sponsored retirement plan in America.[21] As Professor Stabile has noted, once an employer decides to offer a defined contribution plan, however, the employee must make four specific decisions.

First, the employee must decide *whether* to participate in the plan.[22] Second, the employee must decide *what portion* of her salary to contribute to the plan.[23] Third, the employee must decide *how* to invest her contributions and earnings.[24] Fourth, the employee who changes jobs must decide *whether to withdraw* and keep her account balance, keep it with her ex-employer, or transfer it to her new employer.[25] We turn next to the empirical data concerning the first and third decisions—namely which employees decide to participate and which investments they select.

III. EMPIRICAL DATA ON EMPLOYEE INVESTMENT DECISION MAKING

A. Introduction

This section begins by providing data on the percentage of employees who agree to participate in their employers' defined contribution plans by gender, race, ethnicity, and class. It then describes which investment assets they are most likely to select.

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[19] Craig Copeland, *Retirement Plan Participation: Survey of Income and Program Participation (SIPP) Data*, EBRI NOTES (Employee Benefit Research Inst., Washington, D.C.), Sept. 2005, at 2.

[20] Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 7 (2002) (citing U.S. Dep't of Labor, Private Pension Plan Bulletin: Form 5500 Annual Reports § A, n.33 (Winter 1999–2000), *available at* http://www.dol.gov/dol/pwba/public/programs/opr/bullet1996/hilites.htm.).

[21] PATRICK PURCELL, CONG. RESEARCH SERV., RETIREMENT PLAN PARTICIPATION AND CONTRIBUTIONS: TRENDS FROM 1998 TO 2003 (2005), *available at* http://opencrs.cdt.org/rpts/RL33116_20051012.pdf. The Department of Labor's *National Compensation Survey* reported that 53% of employees in the private sector worked for employers offering defined contribution plans in March 2005, and 22% worked for employers offering defined benefit plans. *Id.*

[22] Stabile, *supra* note 3, at 78 ("Thus, the first choice presented to employees in a defined contribution plan is whether to participate in the plan.").

[23] *Id.* ("The employee must decide what percentage of her salary to contribute to the plan . . . .").

[24] *Id.* ("The employee must decide . . . how to invest her plan contributions and earnings.").

[25] *Id.* ("An employee who leaves employment prior to retirement must decide whether to take a current cash distribution of her 401(k) plan account balance, or whether to allow the account balance to continue to accumulate by leaving the money in the existing employer's plan or rolling over the contribution to a new plan or an IRA.").

B. Should I Participate?

In 2005, almost sixty percent (59.7%) of employees worked for an employer who sponsored a retirement plan, and slightly more than half (51.6%) participated in the plan.[26] In 2004, both percentages were higher—almost sixty-two percent (61.8%) worked for an employer who sponsored a retirement plan, and more than half (53.4%) participated in the plan.[27] Between 1990 and 2000, the percentage of men who worked for an employer that sponsored a retirement plan increased from 63.3% to 66.2%. However that percentage has dropped to 58.6% for 2005.[28] Between 1990 and 2000, the percentage of women who worked for an employer that sponsored a retirement plan increased from 62.1% to 66.4%. That percentage has also dropped to 61.3% in 2005.[29] It is interesting to note that in 2005, a higher percentage of women (61.3%) worked for employers who sponsored retirement plans, than men (58.6%). However, the percentages for both men and women generally have been declining since 2000. There was relatively little difference in men and women participating among full-time employees. Slightly over half of men (51.4%) and slightly over half of women (52%) participated in their pension plans.[30]

Black, Hispanic, Asian and Native American workers were less likely to have worked for an employer that sponsored a pension plan and less likely to have participated in the pension plan than whites.[31] In 2005, 65% of whites worked for an employee who sponsored a plan, followed by 57.2% of blacks, 56.6% of Asians and Native Americans, and 37% of Hispanics.[32] In 2005, 57.3% of white employees participated in the plan, followed by 48.8% of Asian and Native American workers, 46.5% of black workers, and 29% of Hispanic workers.[33] One would expect the disparity in participation to result in disparity in pension account balances at retirement. While this precise information is difficult to obtain, proxy data will be examined.

One study showed that while 79% of white employees had pension wealth, 66% of black employees and 47% of Hispanic employees had pension wealth.[34]

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[26] *See* PATRICK PURCELL, CONG. RESEARCH SERV., PENSION SPONSORSHIP AND PARTICIPATION: SUMMARY OF RECENT TRENDS (2006), http://www.opencrs.com/rpts/RL30122_20060831.pdf. *Cf.* Stabile, *supra* note 3, at 80 ("[P]articipation rates in 401(k) plans vary between 50% and 90%."). *See also* Richard L. Kaplan, *Enron, Pension Policy, and Social Security Privatization*, 46 ARIZ. L. REV. 53, 60 (2004) ("The most comprehensive data available show that only 56% of full-time private sector employees participate in any sort of pension plan.").

[27] Purcell, *supra* note 26, at 8.

[28] *Id.*

[29] *Id.* at 8–9.

[30] *Id.*

[31] *Id.* at 11.

[32] *Id.*

[33] *Id. See also* Brown, *supra* note 2, at 1535–36 (describing how Asians are slightly more likely to participate in employer provided pensions than blacks and that Hispanics are the least likely to participate).

[34] *See* Sharmila Choudhury, *Racial and Ethnic Differences in Wealth and Asset Choices*, SOC. SEC. BULL.. issue 4 2001/2002, at 1, 2. ("This article is based on data from

The median value for white pension wealth is $37,721, for blacks it is $24,076 and for Hispanics it is $0.[35] That Hispanics trail behind whites and blacks will be a recurring theme in this Article, but here the difference is most dramatic.

Regarding class, in 2005, almost seventy-five percent (74.4%) of workers who earned more than $60,000 worked for employers who sponsored a pension plan, followed by 68.6% of workers who earned between $38,000 and $60,000, followed by 59% of workers who earned between $25,000 and $38,000, followed by 39% of workers who earned less than $25,000.[36] These percentages have declined since 2000, where 80.2% of workers who earned more than $60,000 worked for employers who sponsored a pension plan, followed by 74.3% ($38,000–60,000), 66% ($25,000–38,000), and 44.9% (less than $25,000).[37] In 2005, the percentage of workers who actually participated in their pension plan was 70.3% (>$60,000), 61.5% ($38,000–60,000), 49.8% ($25,000–38,000), and 27.5% (<$25,000).[38] Those percentages also declined since 2000, when 75.5% of workers earning more than $60,000 participated, followed by 67.1% ($38,000–60,000), 55.5% ($25,000–38,000), and 32.1% (<$25,000).[39]

Several observations can be made from the data. First, men and women who are full-time workers are equally likely to participate in their pension plans. Second, whites are more likely to participate in their pension plans than non-whites, with Hispanic employees the least likely to participate and as a result, whites have higher median pension wealth than blacks or Hispanics. Third, Asians are more likely to participate than blacks or Hispanics in their pension plans. Fourth, higher income employees are significantly more likely to participate in their pension plans than lower income employees. However, no group of employees participates at a rate approaching 100%, which means there is much work to be done.[40]

C. *How Should I Invest?*

Next we consider employee investment behavior which would be expected to impact account balances at retirement. Generally defined contribution plan

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wave 1 (1992) of the [Health and Retirement Study], matched, when permitted by respondents, with Social Security administrative data and employer-provided pension information."). The final sample used consisted of 5,362 households, 3,895 were married households. *Id.* at 3.

35 *Id.* at 6.

36 PURCELL, *supra* note 26, at 12–13.

37 *Id.*

38 *Id.*

39 *Id.*

40 Stabile, *supra* note 3, at 80 ("There is only one rational answer to the question whether or not to participate in a defined contribution plan. All retirees need adequate retirement income. Social Security, always intended to provide only supplemental retirement income, does not pay benefits in an amount sufficient to provide an adequate retirement standard of living. Therefore, the opportunity to save for retirement in a tax-favored fashion is not one that can rationally be passed up. Yet, there is nowhere near 100% employee participation in defined contribution plans.") (citations omitted).

participants over-invest in conservative fixed-income options—this is especially true for low income employees.[41] As a result, they under-invest in stocks—other than employer stock.

For example, plans that offer guaranteed investment contracts and/or employer stock funds decreased the percentage of employees who selected non-employer equity funds.[42] Put another way, employees had the highest allocations in non-employer equity funds where they did not have the option of investing in a guaranteed investment contract or employer stock funds. In addition, where an employer's plan required that a company match be invested in employer stock, employees invested a higher percentage of their self-directed funds in employer stock.[43] Further, studies reveal that among large companies offering employer stock as an investment option in 401(k) plans, employees over invest in employer stock. Between 30 and 40% percent of plan assets are invested in employer stock and in several large plans at least 90% of the assets are invested in employer stock.[44] This is especially true for low income employees who are "three to five times as likely to have 80 percent or more of their retirement plan savings in [employer] stock than at the highest wage levels."[45] Federal law, however, prevents employers in defined benefit plans from investing more than ten percent of plan assets in employer securities.[46]

[41] *Id.* at 89–90 ("Many defined contribution plan participants invest too conservatively to ensure sufficient benefits at retirement—disproportionately investing in fixed-income options. This is particularly true of lower-income participants.") (citations omitted).

[42] *Id.* at 87 ("The EBRI compared plans offering guaranteed investment contract (GIC) and employer stock funds, plans offering one but not the other, and plans offering neither. It found that participants in plans offering neither option have the highest allocations to equity funds, that plans offering an employer stock fund but no GIC fund have substantially lower allocations to all other investment options, and that participants in plans with a GIC fund but no employer stock fund have lower allocations to bond, money market, and equity funds.") (citations omitted).

[43] *Id.* ("The EBRI also found that where a plan requires that a company match be invested in employer securities, participants tend to direct a higher percentage of their self-directed funds into that option as well.") (citations omitted).

[44] *Id.* at 90–91 ("401(k) plans of large public companies typically offer employer securities as one of their investment options and participants in such plans frequently invest their plan accounts disproportionately in that investment option. Studies reveal that among large companies offering employer securities as an investment option in 401(k) plans, upwards of 30% to 40% of plan assets are invested in employer securities and in a number of large plans, 90% or more of the assets are invested in that option.") (citations omitted). *See also* Kaplan, *supra* note 26, at 72–73 (showing "extraordinarily high levels of 401(k) plan investment in company stock is a phenomenon that crosses industry lines and is a feature common to both 'high tech' and more traditional corporations.").

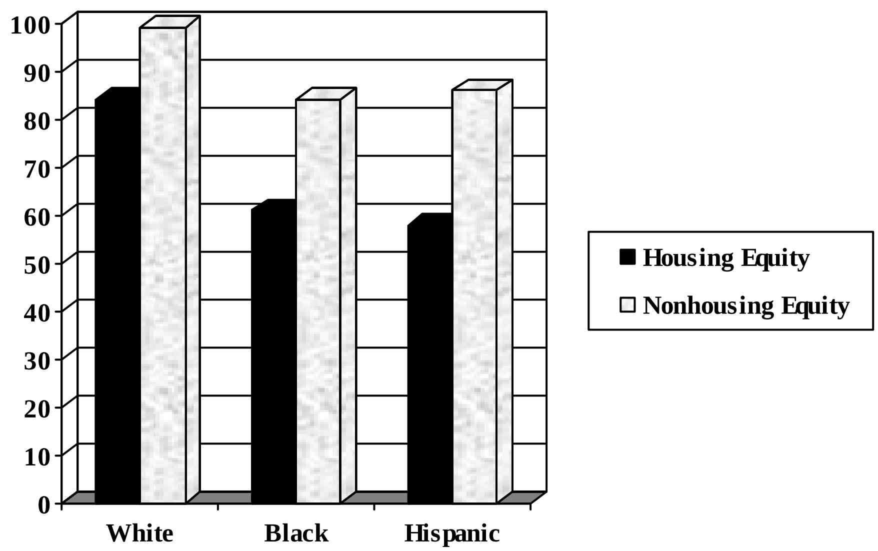
[45] Stabile, *supra* note 3, at 91 (citations omitted).

[46] *Id.* at 94 (citing 29 U.S.C. § 1107(a)(2)(1994)) ("(providing that plans other than individual account plans only may acquire employer securities if fair market value of employer securities and real property held by plan immediately after acquisition does not exceed 10% of fair market value of plan's total assets). Even then, a defined benefit plan may invest in employer securities only if no more than 25% of the outstanding stock of the same class is owned by the plan and at least 50% of the outstanding stock of the same class is owned by persons independent of the employer. *See* §§ 1107(d)(5), (f)(1))".

D. Racial and Ethnic Differences in Investment Decisions

The data in this section is drawn largely from one study which examined the race, class, and educational backgrounds of employees who were near retirement.[47] Many of the points made in this study however, are consistent with prior studies.[48] The study concludes that "at every income quartile and education level, minority households are less likely than white households to own a wide variety of assets—particularly riskier, higher-yielding assets."[49]

Chart 1: Percentage of Sample Population Owning Equity[50]



Housing equity is self-explanatory, but non-housing equity needs additional clarification. Non-housing equity consists of the following financial assets: liquid assets, stocks, bonds, IRAs/Keoghs, and other assets (including a second home).[51] Liquid assets are considered safe and include checking and savings accounts.[52]

Chart 1 reveals that 84% of whites have housing equity and 99% of whites have non-housing equity. By comparison, 61% of blacks have housing equity

[47] *See* Choudhury, *supra* note 34, at 2 ("This article is based on data from wave 1 (1992) of the [Health and Retirement Study], matched, when permitted by respondents, with Social Security administrative data and employer-provided pension information."). The final sample used consisted of 5,362 households, 3,895 were married households. *Id.* at 3.

[48] *See e.g.*, Andrew Brimmer, *Income, Wealth, and Investment Behavior in the Black Community*, 78 AM. ECON. REV. 151 (1988); Erik Hurst et al., *The Wealth Dynamics of American Families, 1984–94*, BROOKINGS PAPERS ON ECON. ACTIVITY, 1998(1), at 267.

[49] *See* Choudhury, *supra* note 34, at 13.

[50] *Id.* at 6.

[51] *Id.*

[52] *Id.* at 7.

and 84% have non-housing equity, and 58% of Hispanics have housing equity and 86% have non-housing equity.

Chart 2: Median Value of Housing and Non-Housing Equity[53]

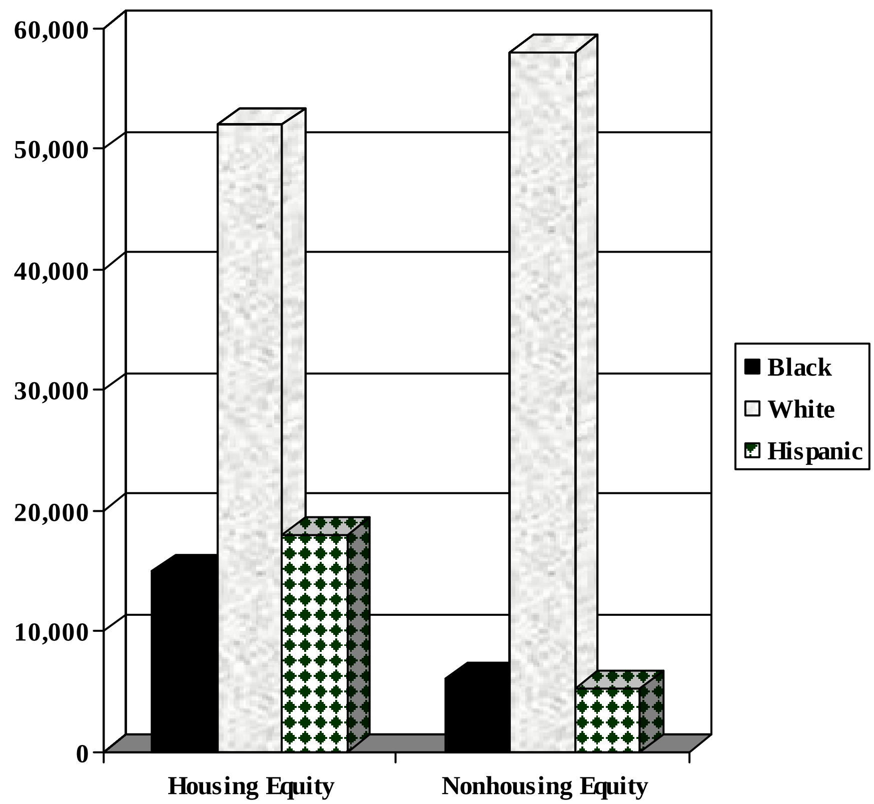


Chart 2 shows there are significant differences when the amount of housing equity and non-housing equity are valued. The median value of white housing equity is more than three times the median value of black housing equity and more than two and a half times Hispanic housing equity. The differences are even greater for non-housing equity. The median value of white non-housing equity is almost ten times greater than the median value of black non-housing equity and almost eleven times the median value of Hispanic non-housing equity. Since investment decision making is largely a function of the types of assets included in non-housing equity, we will turn our attention to non-housing equity comparisons next.

[53] *Id.* at 6.

Chart 3: Percentage Owning Assets[54]

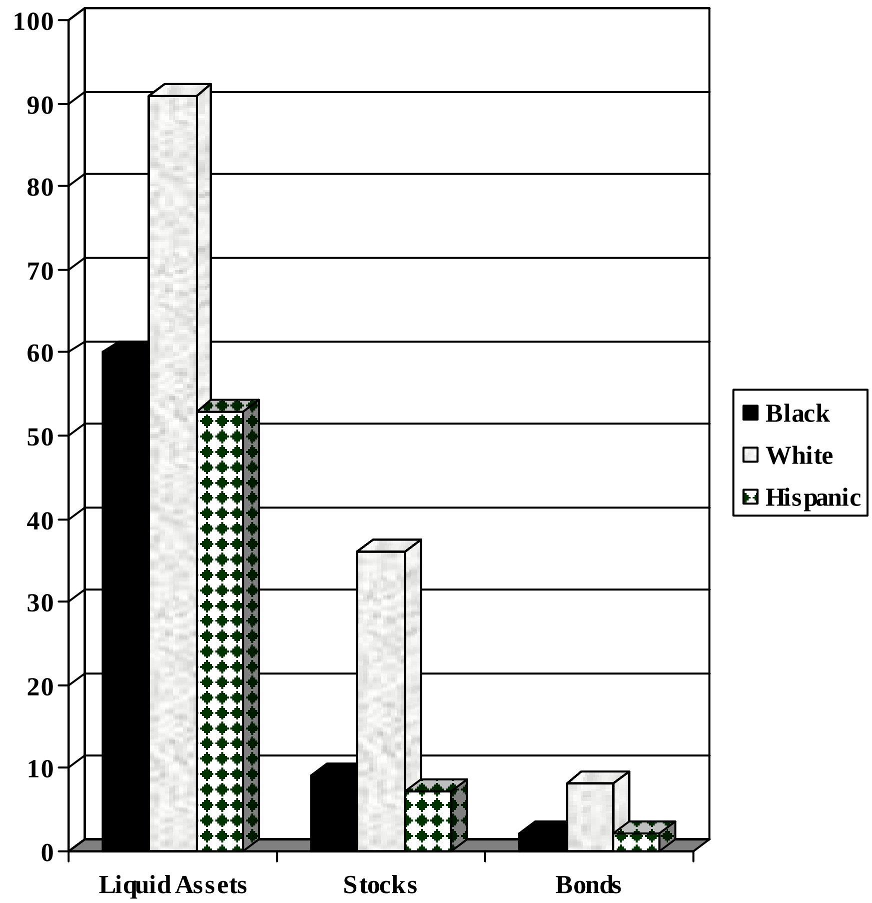


Chart 3 shows that while 91% of whites have liquid assets, 60% of blacks and 53% of Hispanics have liquid assets. While 36% of whites own stocks, only 9% of blacks and 7% of Hispanics own stocks. Finally, while only 8% of whites own bonds, 2% of blacks and Hispanics own bonds. The vast majority of whites, blacks, and Hispanics who own non-housing equity own liquid assets such as checking accounts.

54 *Id.* at 6.

Chart 4: Percentage Owning Assets[55]

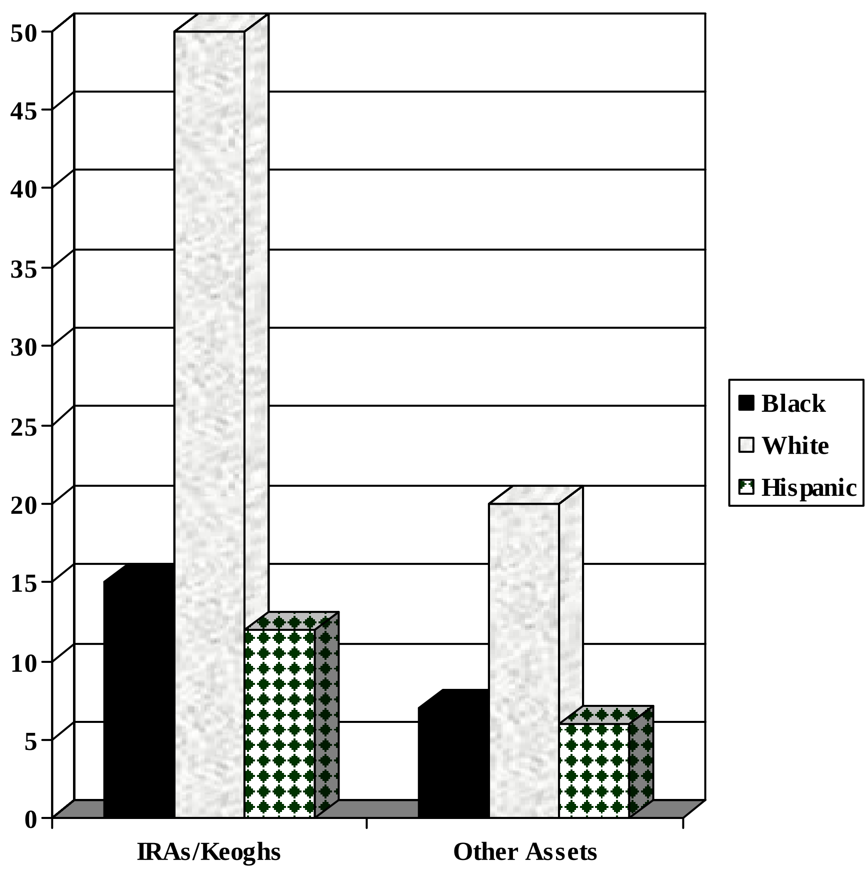


Chart 4 shows that 50% of whites own IRAs and/or Keogh accounts, while 15% of blacks and 12% of Hispanics own those assets. Finally, while 20% of whites own other assets, 7% of blacks and 6% of Hispanics own other assets.

The charts so far have provided dramatic evidence of racial and ethnic disparities in ownership of assets, but I know what you're thinking. You're asking, "is it race or is it class?" There is without a doubt a class dimension to consider. Previously we saw how the higher the income level, the more likely the employee is to participate in his or her pension plan.[56] Does the higher income level equate with higher investment in riskier investments?

The data provided below will be broken down into four different quartiles. The lowest quartile is for households with $23,460 or less of income.[57] The

[55] *Id.*
[56] *See supra* notes 36–39.
[57] *See* Choudhury, *supra* note 34, at 8.

Cite as 11 LEWIS & CLARK L. REV. 385 (2007). Available at http://law.lclark.edu/org/lclr/

second quartile is for households with income between $23,461 and $41,900.[58] The third quartile is for households with income between $41,901 and $66,900.[59] The fourth quartile is the highest quartile and is for households with income over $66,900.[60]

Chart 5: Race/Ethnicity and Income Quartile for Non-Housing Equity[61]

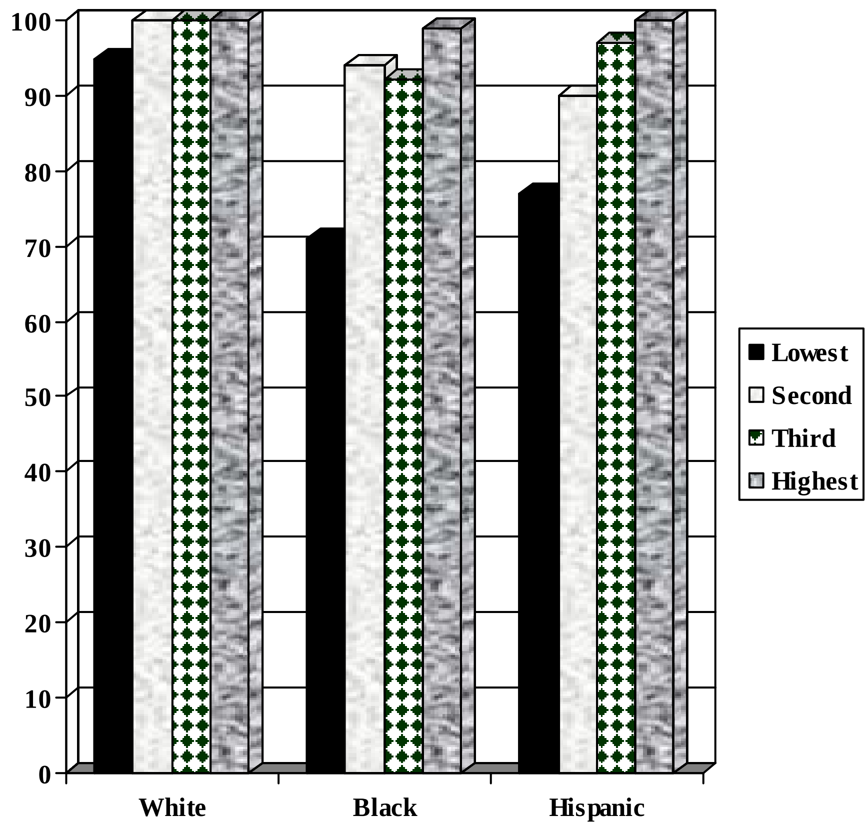


Chart 5 provides that for whites at every quartile, over 90% own non-housing equity. For blacks the range is from 71% for the lowest quartile to 99% at the highest quartile. For Hispanics the range is from 76% at the lowest quartile to 100% at the highest quartile. Since this could represent having checking accounts, we will now examine the ownership percentages for stocks by race and class.

58 *Id.*
59 *Id.*
60 *Id.*
61 *Id.*

Chart 6: Race/Ethnicity and Income Quartile, Percentage Ownership—Stocks[62]

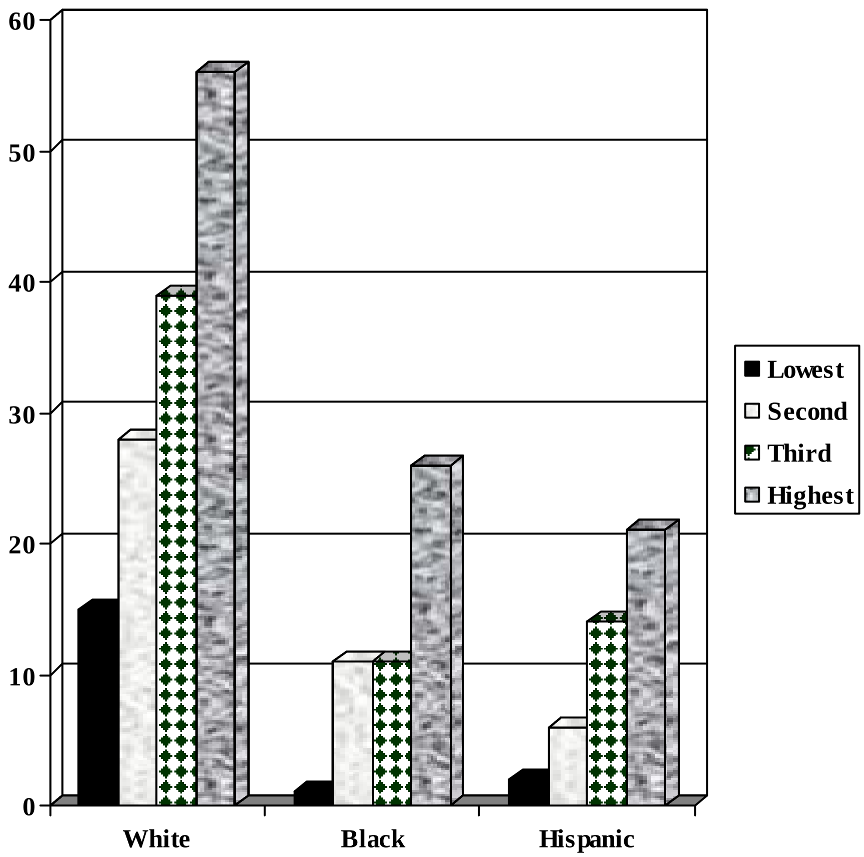


Chart 6 shows that there are significant intra-racial and inter-racial differences. Intra-racially, high income employees all own significantly more stock than their low income counterparts. Four times as many high income whites own stock than low income whites. Ten times as many high income blacks own stock than low income blacks. Seven times as many high income Hispanics own stock than low income Hispanics.

Inter-racially, Chart 6 shows that a significantly higher percentage of whites own stock than blacks and Hispanics. More importantly, at the highest quartile there are significant differences in stock ownership by race/ethnicity. While 56% of whites at the highest income level own stocks, that is more than twice the percentage of blacks (26%) and Hispanics (21%) owning stocks.

At the lowest income levels, the percentage of whites owning stocks is almost ten times greater than the percentage of low income blacks owning

[62] *Id.* at 9.

stocks and eight times greater than the percentage of low income Hispanics owning stocks. It is here that we actually see Hispanics owning a higher percentage of assets than blacks for the first time—at the lowest and third quartiles. A greater percentage of whites in the second lowest income quartile own stock than blacks and Hispanics in the highest income quartile. Chart 6 suggests that blacks' and Hispanics' investment decision making will negatively impact their account balances.

The stock market is considered, over the long term, to be the investment with the greatest returns.[63] To the extent that blacks and Hispanics invest less in the stock market than whites do, their pension fund balances will differ significantly—regardless of income level.[64] Black investors think that real estate is a better place to invest their money than either stocks or bonds.[65] Blacks also think insurance policies are good investment vehicles.[66]

The data just presented supports the view that investing in the stock market is more commonplace for whites than for blacks, regardless of income.[67] However, only 56% of whites invest in the stock market. A significant minority of whites therefore do not. This data is consistent with the existing view that employees generally tend to invest conservatively. Somehow more whites than blacks or Hispanics are able to overcome their conservative investment tendencies. The data show, however, that many employees would benefit from pension reform, especially reform that would increase the percentage of the employee population investing in the stock market—in other then employer stock. Next we look at whether education is a factor in investment decision making by employees.

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[63] *See* Martha N. Ozawa & Yat-Sang Lum, *Taking Risks in Investing in the Equity Market: Racial and Ethnic Differences*, 12 J. OF AGING & SOC. POL'Y 1, 3 (2001); James M. Poterba et al., *401(k) Plans and Future Patterns of Retirement Saving*, 88 AM. ECON. REV. 179, 181 (1998).

[64] *See* Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers*, 65 MO. L. REV. 341, 366 (2000).

[65] *See* Luisa Beltran, *Many Black Investors Back in Market*, S. FLA. SUN-SENTINEL, June 28, 2004, at 21, *available at* 2004 WLNR 20076735 ("[T]he study found that 61 percent of blacks and 51 percent of whites believe that real estate is the best investment overall."); Sandra Block, *African-American Investors Catching Up*, USA TODAY, June 24, 2004, at 2B ("[M]ost black investors believe real estate is the best overall investment . . . ."); Francine Knowles, *African Americans Exit Stocks*, CHI. SUN-TIMES, June 25, 2003, at 65 ("Fifty percent of blacks viewed real estate as the best investment . . . ."); Tristan Mabry, *Black Investors Shy Away from Stocks—Women in Particular are Afraid to Trust Brokerage Firms*, WALL ST. J., May 14, 1999, at A2 ("Blacks . . . tend to favor much more conservative investment vehicles, including real estate and insurance."); Sheila Muto, *The Property Report: Plots & Ploys*, WALL ST. J., June 23, 2004, at B6 ("Black investors continue to think real estate is a better place to invest their money than stocks, bonds or mutual funds, according to a survey of black and white households earning more than $50,000 a year.").

[66] *See* Mabry, *supra* note 65, at 16.

[67] *See* Paulette Thomas, *Investing Survey Shows Race Plays a Part*, WALL ST. J., June 6, 2001, at C21 ("Investing is a rite of passage for white investors . . . [w]hereas a certain income level is what makes the bell go off for black investors.").

Charts 7–10[68] Ownership of Various Forms of Wealth, by Race and Ethnicity and Education

Chart 7

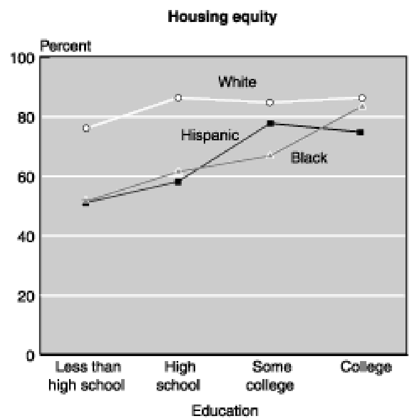
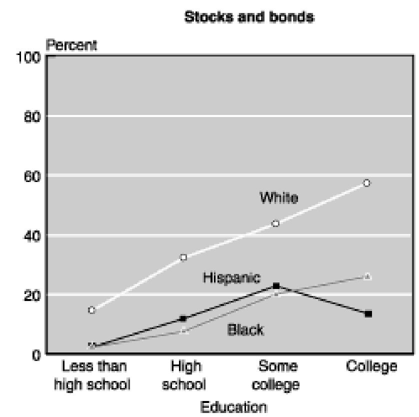


Chart 8



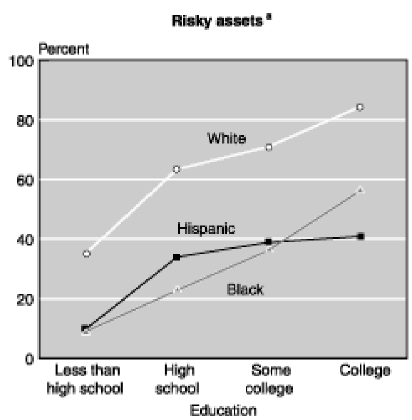


Chart 9

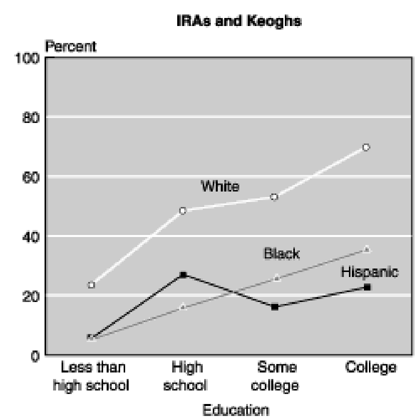


Chart 10

Chart 7 shows the least disparity between percent of ownership of housing equity for black, white, and Hispanic college graduates. What is curious is that for Hispanics, the gap between Hispanics and whites is smaller between those with some college than the gap between those who are college graduates. Put another way, the more education, the less likely Hispanics are to have housing equity. The opposite is true of blacks, and for whites there is only a slight increase in housing equity for a greater degree of education.

Chart 8 shows how a college education widens the gap between whites who own stocks and bonds and Hispanics who own stocks and bonds. While the percentage of whites and blacks who own stocks and bonds steadily increases as education levels increase, for Hispanics, once some college has

[68] *See* Choudhury, *supra* note 34, at 12 (reprinted with permission).

been attained, there is a peak and after that the percentages decrease—approaching that percentage of stock ownership held by Hispanic high school graduates. Chart 8 also shows how among households with less than a high school education, barely 3% of blacks and Hispanics owned stocks and bonds, while 15% of whites did.[69] Whites with less education were more likely than blacks or Hispanics to own stocks—even when blacks or Hispanics had more education. For example, a greater percentage of whites who completed high school than blacks or Hispanics who had completed college, were more likely to invest in risky assets such as stocks.

Chart 9 shows that education does increase the percentage of ownership in "risky assets" which includes stocks, bonds, IRAs, Keoghs, and other financial assets for each racial and ethnic group.[70] However, the widest gap exists between Hispanics and whites, with almost 85% of college educated whites owning risky assets and 40% of Hispanics owning risky assets.[71] Just over 50% of blacks with college degrees own risky assets.[72] Among the least-educated 35% of white households own risky assets compared with just under 10% of black and Hispanic households.[73] As education levels rise, white households increase their ownership of stocks and bonds more rapidly than black and Hispanic households, resulting in an absolute gap that is greater for college graduates than for the least educated.[74]

Chart 10 shows that smaller percentages of black and Hispanic households own IRAs and Keogh accounts than white households.[75] As education increases, so does the ownership in IRAs and Keoghs accounts.[76] However, for Hispanic households, IRA and Keogh ownership is lower among those with some college education than among the least educated households.[77] At the highest education level there is a significant racial and ethnic gap. Two-thirds of white college graduate households own IRAs and Keogh accounts, while just over one-third of black and one-fourth of Hispanic college graduate households own IRAs and Keogh accounts.[78]

In summary, after considering class and education level, there remain significant gaps in ownership of assets based upon race and ethnicity. This would suggest that in addition to all the other reasons discussed in this symposium as to why employer-provided pensions are currently flawed, we see one additional reason. Employee decision making is influenced by race and ethnicity. Is this an intractable problem or one that can be ameliorated? It is to that question that we turn next.

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[69] *Id.* at 11.
[70] *Id.* at 12.
[71] *Id.* at 11.
[72] *Id.*
[73] *Id.*
[74] *Id.*
[75] *Id.*
[76] *Id.*
[77] *Id.*
[78] *Id.*

IV. BEHAVIORAL ECONOMICS: WHY WE DO THE THINGS WE DO

Behavioral law and economics explores the legal implications of actual as opposed to hypothesized human behavior.[79] Several articles have been written applying behavioral law and economics to investment decision making by employees.[80] This section will briefly discuss the principal observations that have been made. First, the choice of investment options presented to employees will impact their decision on which investments to select.[81] The average number of investment options offered to employees has increased to eleven, with some in the hundreds.[82] Because many employees are overwhelmed by the choices, they tend to invest in more conservative options—especially low income employees.[83] In addition, how the investment options are presented to employees will affect their investment decisions.

One study looked at the educational sources available to investors.[84] All employees in the study were given identical information on historic equity premiums, but the manner of presentation was different.[85] One group received charts showing actual distributions of historic returns in one-year increments, and this group invested less in equity securities than the other two groups.[86] Those two groups received charts showing the distribution of annual rates of return on a thirty-year investment. [87] The researchers concluded that the way in which information is presented to investors in benefit plans influences their investment decisions.[88]

Employees tend to follow the market—buying high and selling low.[89] Employees also tend to be passive investors and stay with the investment decision they made when they first enrolled in their plan.[90]

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79 Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1476 (1998) ("The task of behavioral law and economics, simply stated, is to explore the implications of *actual* (not hypothesized) human behavior for the law.") *See also* Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199 (2006).

80 *See e.g.*, Stabile, *supra* note 3; Muir, *supra* note 20, at 11 (citing to Sendhil Mullainathan & Richard H. Thaler, *Behavioral Economics* (Nat'l Bureau of Econ. Research, Working Paper No. 7948, 2000), *available at* http://www.nber.org/papers/w7948.).

81 Stabile, *supra* note 3, at 87.

82 *Id.* at 89.

83 *Id.* at 89–90.

84 Muir, *supra* note 20, at 12.

85 *Id.*

86 *Id.* at 12–13.

87 *Id.* at 12.

88 *Id.* at 13.

89 *See* Stabile, *supra* note 3, at 90.

90 *Id.* ("In stark contrast to the active management of investments one finds in a defined benefit plan, one study found that 60% of 401(k) plan participants stuck with the initial investment decision they made when first joining the plan. This may be either because the complexity of the choice leads to procrastination or because participants fear making a change that may turn out in hindsight to have been unwise.") (citation omitted).

Employees tend to over-invest in employer stock.[91] The reasons given are varied. First, employees are overconfident in their employer.[92] Second, employees over-invest out of a sense of loyalty.[93]

What employees want and need is specific investment advice, something which employers are afraid to provide for fear of being found to be a fiduciary.[94] Education, it is feared, won't solve the issue. Several studies show that education efforts have not countered the bias toward conservative investment decisions.[95] Neither have automatic enrollment options. Employees subject to automatic enrollment tend to retain the conservative default investment options established by the plans.[96] Those employees least likely to

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91 *See supra* notes 44 & 45.

92 *See* Stabile, *supra* note 3, at 91 ("First, many employees invest heavily in their employer's stock because of overconfidence in the employer, which can be viewed as a version of the optimistic bias that makes employees think that other companies are more likely to experience problems than their own. Although they recognize that diversification of investments is desirable, they feel that an investment in their employer's stock is less risky than investments in other stocks. The behavior thus may be a product of bounded rationality; participants know they lack the ability to suitably judge the entire array of investment choices and substitute confidence in the employer for doing so.") (citation omitted).

93 *Id.* at 92. ("Second, many employees invest heavily in employer stock out of a sense of loyalty to their employers, an example of bounded self-interest. This loyalty may be particularly true of women, who make up a growing part of the workforce. However, it is by no means limited to women, as illustrated by the story of the General Motors (GM) executive who, despite his participation in all discussions with analysts about the company's financial prospects, insisted on investing enormous amounts in GM stock as the stock was falling. By the time the stock finished plummeting, he lost $160,000 of his retirement money.") (citations omitted).

94 *Id.* at 93–94. ("Finally, what employees want and what they really need is specific investment advice. As one commentator has suggested, 'Many employees just want to be told how to invest their retirement accounts. They don't want to invest time or money in a soup-to-nuts examination of their entire financial picture.' This reality means that education cannot be successful within the current legal regime. The fact that the law permits employers to avoid fiduciary status with respect to employee decisions so long as they do not offer investment advice constrains the type of education offered. Since attempts to educate employees take place within the guidelines that prevent such education from resulting in the employers being deemed to give investment advice, employers will not give individually tailored advice to employees.") (citation omitted).

95 *Id.* at 93. ("First, several studies have shown that educational efforts have not been successful in countering participant bias toward conservative investment decisions. Second, education is unlikely to affect decisions with respect to investments in employer securities that are the product of bounded self-interest. Because employees' decisions to invest in employer securities are frequently based on emotional and psychological factors, providing employees with general investment information and asset allocation models does not get at the root of their decisions. As suggested above, even employees who are generally sophisticated and who appreciate the dangers of excessive investment in a single stock overinvest in employer securities. That overinvestment continues despite attempts to educate employees.") (citation omitted).

96 *Id.* at 82. ("Inertia has another significant effect in plans with automatic enrollment features. Both Madrian and Hewitt find that participants subject to automatic enrollment also have a tendency to retain the conservative default investment options established by the plan. In the company that Madrian studied, 80% of automatic enrollment participant contributions are allocated to the money market fund and 16% in stock funds, compared to 70% in stock

increase their contribution rate and make changes in the default investment options are lower-income employees—those earning less than $20,000.[97] Automatic enrollment rules increase participation levels, but don't increase contribution levels above the default floor or default investment allocation decision.[98]

While scholarship has addressed class bias in investment decision making, it has not taken into account race or ethnic bias. I have previously discussed several reasons why blacks are less likely to invest their money in the stock market than whites.

> One is that investing in the stock market is commonplace for Whites but not Blacks. Another is the lack of diversity in the financial markets industry. A third is general distrust. A fourth is that Blacks are more comfortable investing in real estate and insurance because they know Black real estate and insurance agents. [99]

Blacks and Hispanics are less likely to invest their money in the stock market than are whites.[100] Others have offered up additional explanations.

> What explains the hesitancy of minority groups to invest in risky financial assets? Lack of an appropriate financial environment in the home has occasionally been put forth as a cause, as has a lesser taste for risk, the higher information costs of acquiring newer kinds of assets, or both. Another possibility is that, by primarily targeting whites, financial brokers have created in minority communities a cultural bias against investing in riskier financial assets. Blacks have traditionally been more willing to invest in real estate and certificates of deposit because those

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funds and less than 10% in the money market fund for other plan participants. This is because the vast majority of participants subject to open enrollment do not change the default investment options. In the two companies studied by Hewitt, more than half of the participants subject to automatic enrollment fail to change the default investment options.") (citations omitted).

[97] *Id.* at 82–83 ("Notably in terms of the goal of enhancing retirement security, those least likely to increase their contribution rate and make changes in the default investment options are lower-income employees. Madrian finds that over 70% of employees earning less than $20,000 suffer from the inertia effect, compared to less than a third of employees earning between $70,000 and $79,000. She suggests as one explanation for that inertia the complexity of decisionmaking and costs of gathering the necessary information to change investment options. It also may be that uncertainty about the outcome of changing investment choices leads to inertia, generated by fear of regret over a change that results in a loss. This may be fueled by the possibility, as Madrian suggests, that some participants may view the default investment allocation decisions as advice or a recommendation by their employer that the default choice is a good one, a notion supported by the fact that many employees who change the default contribution rate fail to change the default investment election.") (citations omitted).

[98] *Id.* at 83.

[99] *See* Brown, *supra* note 2, at 1537. (citations omitted).

[100] *See* Ozawa & Lum, *supra* note 63, at 5 ("We posit that black and Hispanic people are not only less likely to invest in the stock market than are white people, but that they invest a smaller portion of their total assets, net of home equity, in the stock market."). One explanation as to why Hispanics don't participate as much as other groups, is regarding foreign-born Hispanics' familial obligations which may require them to send funds elsewhere.

industries have marketed their services to blacks and have agents who are themselves black.[101]

Whether employees have built-in biases which impact their investment choices has clearly been established. Potential solutions to counteract those biases will be the subject of the final section of this Article.

V. REINVENTING DEFINED CONTRIBUTION PLANS

This section provides suggestions for increasing account balances in racial and ethnic minorities as well as white employees. To the extent that minorities and non-high income white employees are risk averse and do not invest in the stock market to the extent that they should, automatic enrollments should be encouraged—with a default investment portfolio allocation based upon age. It is well known that younger employees can absorb more risk than employees close to retirement. That information can be taken into account in creating a default investment portfolio allocation rule.[102]

To the extent that employers are concerned that providing such specific advice might subject them to fiduciary liability, they should partner with community-based organizations that can provide the needed specific information. In addition, community based organizations should reach out to K–12 students to encourage investing in the stock market by emphasizing the different long-term outcomes of a variety of investment options. Professor Lewis Mandell has documented the lack of financial literacy of our youth.[103] He suggests that financial education should begin sooner both at home and at school and should teach students how to invest in the stock market.[104]

Wall Street should also reach out to racial and ethnic minorities with investment advice in two ways. First, they should take care to hire more racial and ethnic minority members as stock brokers.[105] Second, they should market

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[101] *See* Choudhury, *supra* note 34, at 13 (citations omitted).

[102] *Cf.* Pension Protection Act of 2006, Pub. L. No. 109-280, § 508, 120 Stat. 780, 950.

[103] *See* Stephen Gandel, *Everything You Know About Kids and Money is Wrong*, MONEY, Aug. 2006, *available at* http://www.mutualofamerica.com/articles/Money/2006August/money.asp.

[104] *Id. See also* Creola Johnson, *Welfare Reform and Asset Accumulation: First We Need a Bed and a Car*, 2000 WIS. L. REV. 1221, 1274 ("In a seminal study sponsored by the Jump$tart Coalition for Personal Financial Literacy, Professor Lewis Mandell found that the majority of 1,532 high school seniors received a failing grade in a test measuring literacy regarding personal finances."). *Cf.* Creola Johnson, *Maxed Out College Students: A Call to Limit Credit Card Solicitations on College Campuses*, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 191, 226 (2005) ("A nationwide study like Jump$tart for college students does not exist, although a few studies conclude that college students have low levels of personal finance literacy.").

[105] *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1271 n.390 (1999) ("Arthur Levitt, Jr., Inclusion and Diversity on Wall Street, Remarks before the Wall Street Project/Rainbow-PUSH Coalition (Jan. 16, 1998 . . . (announcing a series of SEC roundtable discussions with CEOs of corporations and securities firms to discuss ways to promote diversity in hiring)."); Marianne Jennings & Stephen Happel, *The Post-Enron Era for Stakeholder Theory: A New Look at Corporate Governance and the Coase Theorem*, 54 MERCER L. REV. 873, 880 n.19

their products more broadly—there's a vast market of potential customers in need of their services.[106]

Employees should be informed of the long-term consequences of their current investment strategies. For example, the opportunity costs of investing in low-risk investments as opposed to stocks should be demonstrated for employees. In that way, employees can see the real world consequences of their choices. Conventional wisdom provides that risk can more easily be absorbed when you're younger than older. Therefore, a default rule could be based upon such knowledge. In addition, employees should be informed that the employers are prevented in certain plans from investing more than ten percent in employer-stock.

VI. CONCLUSION

Retirement security should be a fundamental expectation of all workers. The data show certain employees are more likely to have a financially insecure future, especially blacks and Hispanics. All employees, however, would benefit from reform efforts targeted at changing their conservative investment choices. This Article provides several suggestions which would better secure the retirement futures of those most at risk of being left behind in an increasingly global society.

(2003) ("Rev. Jesse Jackson has been involved in his 'Wall Street Project Initiative,' designed to bring more representative (in a racial sense) investors and customers to businesses. David Barboza, *Toyota Earmarks $8 Billion for Diversification Efforts*, N.Y. TIMES, Aug. 10, 2001, at C3.").

[106] *But see* Lisa Fairfax, *The Thin Line Between Love and Hate: Why Affinity-Based Securities and Investment Fraud Constitutes a Hate Crime*, 36 U.C. DAVIS L. REV. 1073, 1074 (2003) ("Over the past several years, securities regulators have reported a dramatic rise in 'affinity fraud'—securities and investment fraud that targets identifiable racial, ethnic, or religious groups perpetrated by members of the group or people claiming to want to assist members of the group. Perpetrators of affinity fraud rely on traditional fraudulent investment schemes, but instead of choosing victims based primarily on their economic profile, such perpetrators target victims based on their racial, ethnic, or religious affiliation. This targeting has proved extremely successful.") (citations omitted).