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From: girardinmalibu@charter.net [mailto:girardinmalibu@charter.net]
Sent: Friday, February 05, 2010 5:06 PM
To: EBSA, E-ORI - EBSA
Cc: girardinmalibu@charter.net
Subject: RIN 1210-AB33 request for comments on retirement security

Please see the attached web link and text, which appeared in public at Governing.com's web site, for fresh thoughts on how to provide lifetime income for individual citizens through a pension exchange.

I stand ready to assist Treasury upon request, and have served previously as an advisor (Dave Walton, on arbitrage regs) and the White House (advisory commission on historically black colleges).

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http://www.governing.com/column/seeking-security-retirement-funds

Pension-exchanges for IRAs and 401(k)s would strengthen President Obama's initiatives.
By Girard Miller | February 4, 2010

News reports indicate that the U.S. Treasury and the Department of Labor will soon begin soliciting ideas for how to provide retirement income security to IRA and 401(k) investors. The agencies' request for public comments reflects a continuing interest in this topic by Mark Iwry, the Treasury's top gun in the retirement field and a respected expert in retirement plan design and taxation. Iwry has himself written on the topic in his private life before joining Treasury Secretary Timothy Geithner's team. The Obama administration linked this idea to its State of the Union initiatives to enhance Americans' retirement security, so the idea already has some White House buy-in.

The idea of providing a secure lifetime income stream for IRA and defined contribution plan investors gained momentum after the market plunge of 2008 turned 401(k) plans into "201(k)" plans. Even with the recent stock market rally, they are still only "301(k)" plans, because most investors are still down 25 percent from their peak levels in the 2007 stock market. Providing stable retirement income for a lifetime is just something that a mutual fund, corporate bond or bank CD cannot promise.

The primary lobbyists for converting these tax-advantaged accounts into lifetime annuities are insurance companies, of course. They stand to gain the most, as federal encouragement to convert big account balances into annual income payments would drive millions of customers their way. These insurance companies expect to make a profit to compensate them for the risk of underwriting losses that can result from misjudging life expectancies or investing in assets that underperform the required rate of return to pay off the annuities. The problem for Obama's team and the Democrats in general is that these insurance companies are close cousins of those who fought them on health care reform.

Opponents of this retirement security initiative will include mutual funds, the defined contribution investment community, banks and others who profit from large personal retirement accounts that are individually invested.

(As a side note, a covey of blogsters are convinced that the Treasury's request for comments is a smokescreen for a conspiracy to convert IRAs into worthless government bonds in an Argentine-style maneuver to bail out the U.S. Treasury. I don't give any credence to that line of thinking, but for those who now fretting about this scenario, my proposals here will offer a superior solution in a decentralized system.)

A Personal Pension. So, here's a federalist "public option" for the Treasury to consider — a way for state pension funds or state treasurers to rise to the occasion and offer a better mousetrap for the citizens of their respective states. I use the term "public option" advisedly, knowing that it was a nail in the coffin of the recently stalled health-care reform initiative, and suggesting that a decentralized approach should satisfy states-rights advocates who oppose central government monopolies.

Treasury could first allow any state treasurer or statewide pension system to exchange a citizen's 401(k), 401(a), 403(b), 457 or IRA securities portfolio for a taxable retirement pension. States would have to adopt qualifying statutes to authorize these arrangements. Federal tax codes would require revision to permit these exchanges. Federal regulations and state laws would have to include some important safeguards, such as:

• The underwriting fund must be overseen by independent trustees with strict fiduciary requirements, and protected by law from appropriation by the state or anybody else. Assets must be held for the exclusive benefit of participating citizens.

• The actuarial life-expectancy tables used to underwrite the pensions must be conservative to assure that increasing longevity does not leave a deficit for our grandchildren to bail out later.

• Investment return assumptions should be no greater than 85 percent of what pension funds normally assume for long-lived assets. Right now that would be 85 percent of 8 percent — or about 6.8 percent. That would prevent state legislatures, treasurers or pension officials from getting too aggressive in their investment practices, as these are retirees and not young employees. A 6.8 percent return would comport with a conservative-growth asset allocation of 40 percent or less in stocks and the rest in bonds. (This is much more conservative than the typical pension fund, which invests with 60 percent to 65 percent in equities — because incoming participants are still in their 20s and 30s, which allows the funds to take very long-term investment risks.)

• No more than $90,000 of annual pension income can be purchased by any individual, to prevent excessive use by wealthier investors who are well able to find other options for their money and who can afford the market risks that others cannot.

• The funds must establish a reserve for future market losses which takes into account the worst market experiences of the past 80 years (the 1930s, 1973-74 and the 2008-09 bear markets). Any investment surplus beyond such market-stabilization reserves should be credited equitably over the projected lifetimes of participants as a revocable cost of living allowance (COLA). That way, a future market loss would trigger discontinuation of the COLA.

• Any cost-of-living feature must be capped to prevent runaway costs. Appropriate reserves and portfolio hedge policies must be required. COLAs must be reversible and revocable if market values erode reserves.

• The exchanges must be optional and voluntary. No Argentine-style commandeering of 401(k) and IRA accounts to bail out state governments. All exchange documents would carry trust law protections as well as contractual rights protected by state and federal constitutions. This Federalist structure would assure the checks-and-balances our forefathers envisioned, in protection of individual rights.

For this to work, the Treasury and DOL must allow tax-qualified defined contribution and IRA plans to hold a "personal pension" issued by a state agency as a qualified asset. The funds transferred from the individual's accounts would be exempt from withholding taxes during the exchange, just like an IRA rollover, and then taxed during distributions.

A tax-exempt "Roth" pension. Here's another twist that could be considered as well. The same state agencies that offer these personal pensions could also offer a tax-exempt income stream at a lower interest rate. For example, Congress could allow the state or its pension fund to pay a tax-exempt interest rate of no more than the yield on long-term U.S. government bonds, plus the annuitization of principal over the investor's life expectancy. For those seeking inflation protection, the personal pensions could also be structured to provide a lower initial rate and a cost-of-living feature, using the Treasury TIPS interest rate to set the earnings-rate limits.

By making these pension payments tax-exempt, the Congress would forgo revenue for the amount of the retiree's tax savings versus a taxable pension as described in the prior section. For low-income participants, that won't amount to much, but for those in higher income tax brackets, it could be viewed as a giveaway. Hence it may be appropriate to require that income taxes be paid on some of the tax-deferred account's value at the time of conversion, similar to a Roth IRA conversion. Something like a 5-year income averaging formula would make sense here. Likewise, these tax-free pension exchanges should be disallowed for wealthy investors who own a million or more of tax-free municipal bonds or other tax-preference items like oil depletion — they already have enough tax incentives and retirement security. Middle-class retirees might find the tax-free income a worthwhile benefit, however, especially if it's inflation-protected.

For the states, a tax-exempt payout rate would significantly reduce the level of portfolio risk required, and thus enhance the odds of success.

Creative federalism. Ideally, each state would sponsor its own personal pension plan, much as the popular "529" college savings plans have sprouted across the country. Federal regulations should allow residents of any state that does not offer such an option may participate in another state's programs, which would create a competitive non-profit market for these exchanges. This would assure that all Americans have an opportunity to obtain a competitively underwritten lifetime pension with their personal nest eggs, without resorting to a national monopoly controlled by Congress.

Of course it is conceivable that one of the states or its pension funds could mess up this idea and blunder its way into a financial deficiency through stupid investments or actuarial miscalculations. But how many individual investors are already doing that on their own in the current system? I'd rather bet on the long-term judgment of prudent fiduciaries than millions of naïve individual investors who have no clue about how to invest their 401k and IRA accounts now, with a real risk of outliving their money.

Political notes: Who wins, who loses? As noted above, the mutual fund, banking and defined contribution industry will oppose this approach to retirement security because it would reduce their markets and their profits. Conversely, pension investment managers would gain assets and thus grow their businesses. Actuaries would enjoy a new business line.

State and local government officials and their pension plan administrators might be ambivalent about this idea because for some it will just be extra work. But let's not forget that when people outlive their life savings, they often become wards of the state. With lifetime income protection, there would be a long-term savings in states' welfare costs — which ought to be ample incentive for the states to actively support this idea. Further, this facility would align the interests of public pension funds and their participants with the general taxpayers, who would become close cousins of public pensioners through their personal pension obtained through the state. This alignment of interests could reduce the level of pension envy that continues to build, because individual citizens could purchase the same kind of lifetime income protection that public pensioners receive. (Of course, the average 401(k) participant's $80,000 account balance will only buy her a $7,800 annual pension vs the average public retirees' far more generous full-career benefits, but it would be a step in the right direction.)