Reply to:

DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Parts 2509, 2520 and 2550

RIN 1210–AB33

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

RIN 1545-BJ04

Request for Information Regarding Lifetime Income Options for Participants and

Beneficiaries in Retirement Plans

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Reply for RFI : 28Feb10

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I am an individual investor, and am not any of:

- Employed, contracting, or receiving any financial benefit from investment companies;
- An individual financial consoler or provide advice in any publication or blog;
- Interested in this RFI for any reason other than my personal retirement investments.

1.1 Original Deferred Compensation Plan Goals:

In general terms, the original goal of the Deferred Compensation plans (401k, 403b, IRA) was to incentivize individuals to provide for their own retirement and not rely exclusively on Social Security in retirement. With the decline of classic Pension Plans, Social Security was changing from the original intent of providing a "supplemental income source" to becoming the main retirement income source for the average employee in the US. In 1978, Congress changed the relevant IRS code sections providing for increased deferred compensation investment as an incentive for individuals to provide for their own retirement. This was to contribute to the following:

- Minimize the proportion of the population that relies solely on Social Security for their retirement income;
- Reduce the alarming growth rate of Social Security costs as a percentage of the Federal Budget, especially as the "Baby-boomer" generation begins retiring in 2011.

There may well have been other subordinate goals and agendas associated with this act (both original and subsequent) however, in the terms that this was "sold" to the general public, this was the primary goal and was supported by the public.

1.2 Concerns Raised in : 29 CFR Parts 2509, 2520 and 2550:

As I read the original document and several of the documents referenced in the RIF, I have distilled the essence of the concerns into the following key issues:

1.2.1 Insufficient Contributions:

Department of Labor analysis has shown that the average 401k / IRA contributor is not contributing sufficient funds into their accounts to meet their retirement needs;

1.2.2 Investment Knowledge and Expertise:

Most Americans lack the sophistication necessary to properly manage their retirement funds. Between the high number of investment vehicles and the various risk/reward tradeoffs, Americans can not effectively manage their own money.

1.2.3 Payout Options:

Even if most Americans managed to retire with sufficient funds, lump-sum payouts would still require highly sophisticated investors, and that would result in many Americans burning through their savings too quickly;

1.3 Proposed Remedy:

The document being commented on proposes requiring 401k and IRA funds to offer in part or whole an annuity to ensure a lifetime income stream to the retiree. Part of the “Request for Comment” is what would be the correct proportion up to 100%. There are two ways to do this, however, the document isn’t clear on which method, or perhaps both, would be favored:

1.3.1 Only offer Annuities:

This method eliminates all other investment vehicles within a 401k or IRA (stocks, bonds, mutual funds, etc) and only allows one to purchase an annuity. The annuity would accept contributions during one’s employment years to guarantee an income stream upon retirement;

1.3.2 Annuitize funds upon withdrawal:

This method allows the account holder to continue to direct their 401k and IRA investments into whatever vehicles they desire (within the 401k / IRA rules) for maximum growth. Upon declaring retirement, the funds are used to purchase an annuity that would pay out a steady income stream during retirement. The plan doesn’t specify who the annuity provider would be.

1.3.3 Not Listed : Leave Everything Alone:

This option would mean no substantive changes in how the deferred retirement accounts are handled. Whatever benefits and drawbacks (actual and perceived) exist today will continue as is.

1.4 Comments on Annuity 'Remedy':

Nothing in either proposal addresses the concern that Americans are not saving enough in their deferred savings accounts to provide for their retirement. Neither annuitising nor not annuitizing the accounts at any time from initial contribution through fund withdrawal addresses the savings rate.

The initial goal was to encourage savings through providing tax-deferred status to the monies put into these accounts. With the ever increasing percentage of Americans that do not pay Federal taxes (nearly 50% of income earners in 2010) the advantage of tax deferred accounts is lost, and the penalty of tying up savings with withdrawal penalties until aged 59½ outweighs everything else. It would be instructive to see if the proportion of savings has shifted from tax deferred to after tax accounts for lower income people because of the lost tax benefits.

1.4.1 Option One: Annuities Only:

The first option looks very much like Social Security which is the largest "annuity" in the country, and perhaps the world. Individuals pay into the system and in return, get a lifetime income upon reaching retirement age. However, Social Security differs from private annuities in several key ways:

- There are no "fixed rules" with the US government as there would be under contract law with a private Financial Services companies. Congress regularly changes the rules affecting both the Social Security contributions as well as the benefits Also well known, is that the Social Security funds paid in over decades have been used to minimize the federal deficit and only exist in the form of Treasury IOUs;
- Given that significant Social Security monies have been diverted for general budgetary purposes since 1964 and that starting in 2010, Social Security collections no longer pay for current Social Security benefits, Social Security is now a Ponzi scheme where current "investors" pay for current "beneficiaries". Without some combination of increased FICA taxes and reduced benefits, this is an unsustainable program. (Reference preceding comments about changing the rules after the game as started.)
- If the retiree manages to generate extra retirement income (continued employment, outside investment, etc) then Social Security penalizes them by "means testing" away a significant portion of the otherwise promised income stream. This "means testing" would be extended to the annuity as well. If the means-testing limits aren't changed, virtually ALL of the annuity income could be wiped out due to outside income. Essentially, the government would have confiscated the total account.
- In a private annuity, larger contributions purchase a larger retirement income stream while in Social Security, the benefit is limited. Above a certain contribution level, one gets nothing more for their increased FICA tax;

In fact, there is a substantial chance that this action will eventually lead to the absorption of ALL deferred retirement accounts into the Social Security and will be used to finance the federal budget and not for the benefit of the original savers.

1.4.2 Option Two: Annuitize upon Withdrawal:

The second option allows more flexibility and potentially greater principal grown than an immediate conversion to annuities would allow, however, they still require a certain savvy ness in the account holder to manage the risk/reward.

- The second option still requires a certain savvy-ness in managing the monies invested in the retirement account prior to withdrawal. Depending on how the resultant funds are converted to an annuity upon withdrawal, it might also suffer from some or all of the drawbacks of the first option as well. For instance, should the annuity be "purchased" by the Treasury and paid out in a "Social Security" fashion, it would probably still be a means tested and subject to the dictates of Congress;

- It is interesting to note that while this plan is targeted toward "preventing substantial market losses" in retirement accounts, it ignores the fact that it also prevents "substantial market gains" at the same time. In fact, for non-savvy investors that invest over the long term (20 years or more out of a potential 45 working years) the market always gains.

1.4.3 Option Three: Leave Everything Alone:

What are the implications for these Annuity options for American retirees? This depends almost totally on the type of "plan" that would be instituted. Unfortunately, the original document is very light on details.

- Whatever details are included in this proposal and/or the final act only define how the initial program would operate. Once anything gets into the Federal government's control, it is subject to the political winds of Congress. Rule changes and "clarifications" will change the original act into something completely different. The best "guarantees" of one Congress are worthless when the next Congress or Administration comes of age;

- Nobody can protect someone from themselves. If an investor chooses to make risky investments with or without adequate knowledge, the only way to "protect" them is to confiscate their money and dole it out them later when they need it, less the obligatory Federal duty. Unfortunately, this has two drawbacks:

  - Penalizes the diligent investor that understands that risks sometimes entail a loss and plan accordingly. The penalty prevents those diligent investors from controlling their own future, and eliminates the opportunity to successfully invest for their own future;
  - Any reduction in investment yield (either by the government or by forced use of substandard investment vehicles) represents a loss to the investor. When averaged over the general public, this will represent a lowering of the average American's life standard.

- Annuitizing deferred investments doesn't solve the safety problem. Annuities are sold as a guaranteed benefit very similar to the Defined Benefits programs like the classic Pensions. Annuity providers will do one of the following:

  - Fully fund the annuity. This entails providing a lower than market return rate using the safest securities (US Treasuries less operating expenses) to ensure the final payoff, or
  - Use overly optimistic growth estimates / under fund the annuity.

  Should the first option occur, the annuity owner receives less than they otherwise would have received. Simply investing half in US Treasuries and half in major market index mutual funds will yield better than US Treasuries over a longer term. (Note that anyone can pick a specific year range to conclude anything about market performance. The "lost decade" of 2000 to 2010 looks very different if a slightly different decade is used: 1995 to 2005 yielded 165% gain.).

  If the second option occurs, the more aggressive annuity providers will fail and we're back to the government bailing out the annuity providers to avoid the political fallout. After all, investors will have been sold the idea that annuitizing their savings would guarantee the promised payoff, and they won't let the political leaders off the hook for that promise.

- The inevitable endpoint of this process is to move all independent investor's deferred accounts into the Social Security system. This is the only way the government can "guarantee" the promise of an annuity's payout. Note that the government guarantees this by changing the rules on both contributions and benefits as their funding assumptions prove inadequate. This represents the confiscation of monies carefully set aside and managed by an estimated 80 million Americans as of 2008.

1.5 Thoughts on Better Corrective Action:

The thrust of this proposal is that individual Americans can't be trusted with their own futures. The hidden agenda is that by absorbing these deferred funds into the Federal government, some or all of this money would be available for funding the federal budget (forget about debt reduction, at best it might slow debt growth). History has shown that **NO** government can safeguard a "pot of money" without spending it today in the hopes of replacing it before the owner shows up. However, with huge federal deficits for the indefinite future, the chance of replacing ANY funds is zero. Therefore, if the Federal government gets hold of any of these funds, it represents the confiscation of those funds from the legal owners.

The starting point must NOT be a belief that the American public can't take care of itself, it must be that if sufficient education is provided to Americans, they can take care of themselves. No matter how much the government pretends that it can safeguard citizens from themselves, the promises made will be unsustainable, and eventually a very upset public will realize they've lost again.

1.5.1 Counter Proposal:

Ensure that ALL deferred savings plans offer a full range of "qualified" investment vehicles and brokers:

- Create a list of "qualified investment vehicles" as suggested below (non-inclusive):
  - US Treasuries (considered safest investment). This would provide the same "security" as a Social Security takeover of funds while maintaining proper ownership rights. Investors get the same security without the rule change risk which always ends up with more premium for less benefit;
  - Money-Markets (considered highly safe, some additional risk) as very liquid investments allowing one to move money quickly without charge. This provides the ability to adjust for major economic conditions;
  - Mutual Funds (domestic & foreign) (considered higher risk but greater reward so some individual fund qualification might be needed).
  - Individual Stocks & Bonds (higher risk than Mutual Funds since there is no diversification within a given stock).

  Remember, anyone can invest in any "non-qualified" investment with their non-deferred savings. The goal is to limit risk to the tax deferred accounts.

- Create a list of "disqualified investment vehicles" that represent either too much risk, or too difficult to monitor (non-inclusive):
  - Derivatives more than one step removed from an underlying asset (this would allow Mutual Funds, but not CDS's or CMO's, etc). Individuals can always invest with non-deferred funds if they want to;
  - Investments in the employer's stock (ala Enron). If an individual wants to invest in their employer's, there are non-deferred investment opportunities;
  - Investments whose relative value (stock prices or Mutual Fund NAVs as examples) can't be readily verified;
  - Highly illiquid investments which can't be readily traded. This locks in investments with little change of active management.

- Create a list of qualified investment companies. All retirement deferred accounts must be registered and administered through these qualified companies (no Bernie Madoff's here). (I suspect there's already some level of control here.) These investment companies would meet certain investment practices (non-inclusive):
  - Trade on Public Exchanges. These brokers meet reporting standards such as listing funds on publicly traded exchanges that report fund NAVs daily;
  - Publicly Owned with an independent Board of Directors;

- Companies that undergo annual audits and SEC reviews.

Provide better education for individual investors:

- Create a simpler preface to the Prospectus that explains the investment goals and risks for any particular investment. Leave the detailed accounting information in the main following sections, and target this preface to risk/reward tradeoffs. Provide some kind of comparison against other risk categories. Much of this already exists with most major investment companies. The most difficult part is to set Prospectus standards that make sense;
- Create an investment strategy booklet that is distributed as part of the 401k/403b/IRA investor signup package. All of this information is already available online from the larger investment companies, so it wouldn't be difficult. (The best option would be to require an investment and money management course requirement in high school so the US doesn't continue to graduate fiscally ignorant citizens.) Lacking public school education, an industry website monitored by the SEC for accuracy that explains investment risk/reward and strategy (but not advertise either investment companies or vehicles) would help prevent ignorant investment strategies.

Prevent Unethical or Unsustainable Investments:

- Start all contribution allocations in US Treasuries or Money Markets. Though the yield is small, it is very safe. For those investors that don't understand the market, they can just leave it there, and it will provide the same growth opportunities as an annuity;
- Better SEC monitoring of investment companies. As is well know, the SEC had over a decade of clues, allegations, and proof handed to them about Bernie Madoff but failed to follow-up on any of it. This begs two questions:
  - Why should the American public's deferred funding be put at risk for the SEC's failure?
  - If this is the best the SEC can do, why would we trust the Treasury (another government agency) to do better?

  Fix the SEC first before confiscating private funds.
- Prohibit investment in derivatives or any investment vehicle removed more than one step from the underlying security. Investing in pools of swapped agreements concerning what-if scenarios isn't investing, it's speculating. With Mutual Funds, the investor owns funds of the Mutual Funds but not directly in the underlying stock or bond. This is the "one step removed" limit. If an investor really wants to get involved in the more arcane investments, they can do so with their own after-tax investment money;
- Prohibit the Federal Government from getting involved in ANY of the tax deferred retirement accounts. There's no difference between a criminal such as Bernie Madoff stealing one's retirement account and that same account disappearing into the US Treasury never to be seen again. In the end, the funds have been stolen from the investor.

1.6 Conclusions:

No policy can force people to save for retirement, so that is not a valid justification for any changes to the existing system. This whole subject of inadequate savings rates needs to be removed from RIN 1545-BJ04 as it is irrelevant.

Any attempt to “fix” the deferred retirement accounts (401k, 403b, IRA, etc) is based on the false assumption that the government can protect the typical American from themselves while providing “better” financial security. Based upon both the **RIN 1545-BJ04** document, other political documents (**Ghilarducci’s** paper for the Economic Policy Institute on **Nov. 22, 2007**), and the current economic situation, it is clear that the real motivation behind this action is to begin the process that will result in the movement of privately held retirement funds into the Treasury to help cover the immense Federal deficits now being spent. With Social Security now paying out more that it collects (an ever increasing problem with the retirement of the baby-boomer generation) it will become a more politically attractive alternative to confiscate private funds to minimize the combination of reduced benefits and increased FICA taxes. Hence, there is **NO** benefit to any investor whatsoever from this plan.

While there are educational enhancements and better SEC oversight opportunities to minimize investor loss through either ignorance or fraud, nothing any government can do will provide a better retirement funding vehicle for the average investor.

The conclusion here is NOT to implement any changes that would annuitize accounts or anything that would move the system toward a merging with Social Security.

Thanks You

Dennis Worden