CONCLUSIONS | SOAPBOX

Not There Yet

IN THE APRIL issue of Investment Advisor, *we featured an article asking, "Does the Federal Government Have a Future in Annuities?" The article described a plan put forth by professors Terrance Odean at the University of California, and Henry Hu at the University of Texas for government-sponsored annuities. The following is a letter in response to that article.*

I read with great interest the referenced article. It was very well written and very timely. With the transition from DB plans to DC plans, and with the groundswell of baby boomers reaching retirement, this is an important topic and one that I have done considerable research on.

Following the Pension Protection Act of 2006, retirement plan regulators have pursued a pension plan reform agenda and the current administration has encouraged annuities to be considered as a distribution alternative. The recent economic crisis has caused retirement plan participants to question the financial viability of investment providers. Banks and insurance companies alike have faced failure and investors have reasonably questioned the safety of their money.

With specific reference to some details outlined in the article, there are some interesting observations to be considered:

1. I agree with the authors that the additional supply of savings might decrease the interest rates paid on government debt, which is the old supply and demand theory. However, the authors did not mention that the same lower interest rates would make the investment returns of the annuities less attractive to the investors.

2. The authors recognized that "the biggest problem … is that people simply aren't saving enough." However, they went on to suggest that investors should choose a government annuity and "manage the rest of their assets in a portfolio." If investors have inadequate savings, what assets are the authors referring to that should be managed separately, considering the conservative payout to be realized by the United States' government annuity?

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3. The second point that is related to the inadequate savings is that the authors suggested investment advisors use the government annuities as a "backstop." That suggests that retirees have an excess amount in retirement assets that could be converted to the annuity if a portfolio drops to a minimum level. Again, the "backstop" is a moot point if investors have inadequate savings.

4. The authors suggested that the government has implicitly guaranteed the solvency of the private annuity-issuing insurance companies. Following the bailouts that occurred during the recent financial crisis, the criticism of the recent bailout seems to me to make the implicit assumption less than a reasonable assurance.

5. One of the reasons for the failing of the Social Security system is the failing of the designers to accurately assess the longevity risks. The authors suggested that the federal government assuming the longevity risks of these annuity products would be only an "incremental move" in cost. The inability to accurately project the incremental cost is contributing to the bankruptcy of the current Social Security program. It is interesting that what the authors suggested looks very much like the current Social Security program in that people and their employers invest in a trust fund that is invested in the United States' government debt that provides an inflation-adjusted "annuity" at a pre-determined retirement age. The financial instability of the current Social Security has become almost infamous.

This article and related topics promise to be very impactful. Retirees are counting on potential solutions that have not come to the forefront yet. Further discussions should be encouraged.

Thank you for writing the article and thanks to professors Odean and Hu for pushing the issue forward.

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