.....15 Years and still rolling.....

Open MIC is open for anyone.

9:00: AM Pacific Thursday 800 504-8071 Code is 5556463

IF YOU WOULD LIKE TO FIND OUT MORE ABOUT US

CALL OR EMAIL

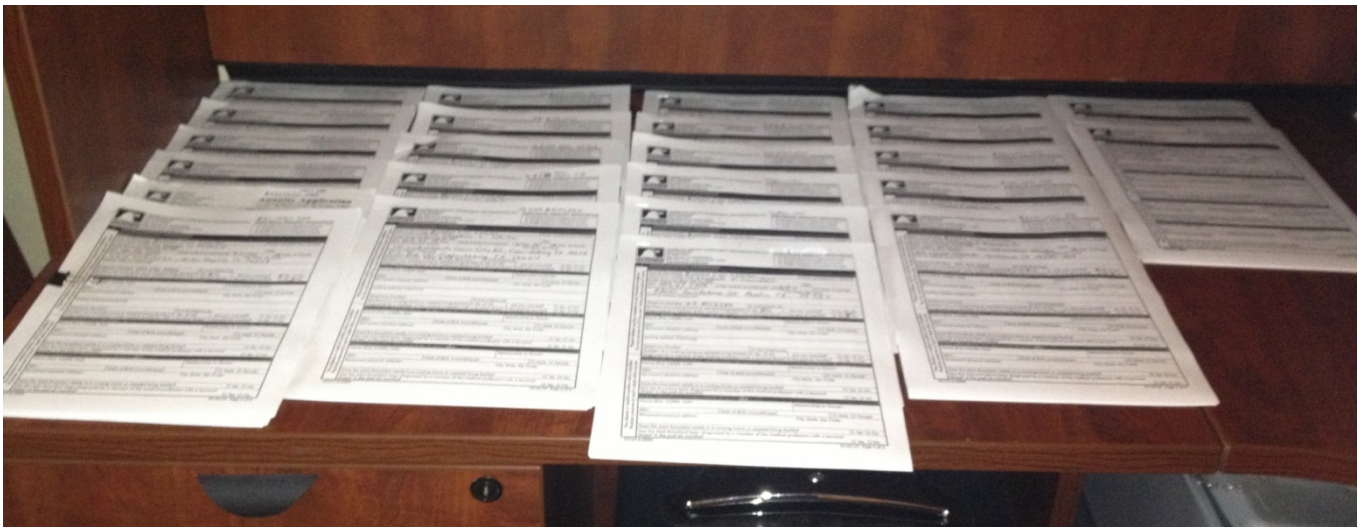
ANTHONY OWEN

888-74AGENT (24368)

tony@annuityagentsalliance.com

OR VISIT OUR WEBSITE

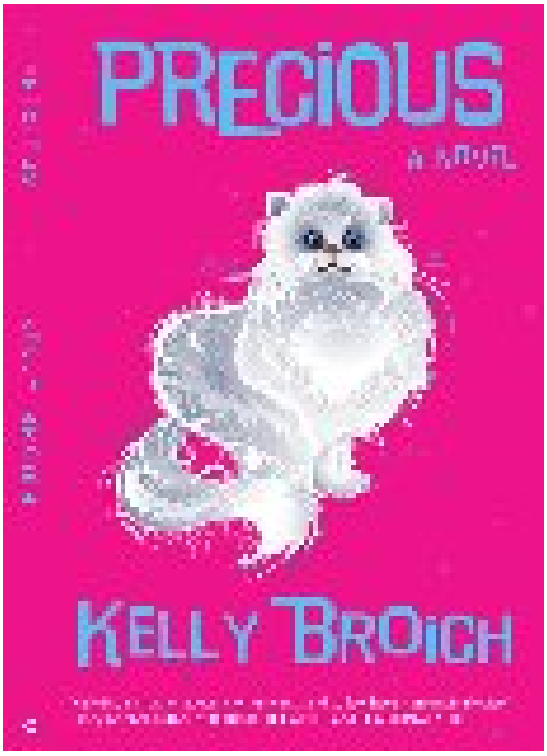
Annuity | Agent's Alliance
Real Help From Real Agents.



Chad's pending applications, 24 for annuity premium of $4,000,000. Nice months' work.

It's Open MIC Time!

9:00: AM Pacific Thursday 800 504-8071 Code is 5556463#



My Son Kelly has been writing stories and plays most of his life, his first novel, *Precious*, has been published. The Idaho Statesman in Boise recently reviewed it. Have a look.

BB

http://www.idahostatesman.com/2013/05/19/2582187/idaho-author-spotlight-precious.html

Here it is at Amazon: http://www.amazon.com/Precious-Kelly-M-Broich/dp/0985941502

(naturally a Boise State product)

Words of Wisdom

"With life-long education, learning becomes a renewable resource."

— Nido Qubein

Sneak Preview: Fixed Indexed Annuities

http://www.youtube.com/watch?v=ChHaRxguEkM

See how Katrina explains FIA!

Dave and Shaun

Product updates

Our friends at VSA sent this to me, solid sales idea, I edited a little, and also this concept is available in many life insurance sales manuals....BB

Great Hook for the Wealthy

Estate taxes, how do you pay them? Currently, each US citizen has a onetime lifetime exemption from federal estate taxes of $5,200,000. A couple would be double.

This means if an estate is in excess of $10,400,000 no tax would be due. But what if the estate is larger or if the estate owner is single and only has a deduction of $5,200,000?

What are the options for paying this tax? Below is a great sales pitch which if used to attract interest in a wealthy person has had great success as a door opener.

The next time you find a wealthy prospect, use this hook.....

"Mrs. Jones the federal government will not accept a percentage of your estate as payment for your estate tax bill. Instead, ***your estate tax bill must be paid in cash****, and it must be paid within nine months after your death."*

If your estate is subject to the federal estate tax, there are **FOUR** ways to provide your estate with the cash needed to pay your estate tax bill:

1. 100% METHOD

You could accumulate enough cash in your estate to pay your estate tax bill outright. Rarely, however, does a successful person accumulate such large

sums of cash. Instead, the reason for financial success is usually due to the investment of cash in appreciating assets, rather than accumulating it in a bank.

2. 100% PLUS METHOD

Your estate could borrow the cash needed to pay your estate tax bill. This, however, only defers the problem, since the money will then have to be repaid with interest.

3. ASSET LIQUIDATION METHOD

Your estate could liquidate sufficient assets to pay your estate tax bill. This choice may make sense if your estate owns considerable assets that can be readily sold for a gain following your death. Keep in mind, however, that if a forced liquidation is necessary, it may bring only a small fraction of the true value of your assets. In addition, sales expenses are bound to be incurred.

4. DISCOUNT METHOD

Assuming you qualify, you can arrange now to pay your estate tax bill with life insurance dollars. For every dollar your estate needs, you can give an insurance company from approximately one to seven cents a year, depending on your age and health. **No matter how long you live, it is unlikely you will ever give the insurance company more than 100 cents on the dollar.** In addition, the life insurance policy can frequently be structured to accommodate your unique premium payment requirements

Here is a surprising statistic: at age 65, male ns can buy $1,000,000 guaranteed death benefit, guaranteed premium for $16,000 a year. It would take 62 years before the paid premium would exceed the death benefit!

Now that is a discount!

Big Truck Partners

"It takes a village to raise an annuity agent!"

Q: How did you write $4 million in one month?

Anthony R. Owen

Open PDF, Concerns of Baby Boomers

There are 13 concerns of Baby Boomers; this would make a good mailer or handout piece.

From health concerns to the stock market to retirement, nice easy to understand handout with referenced links, here is an example.

1. **Annuities:** How they can work for you and how they cannot work for you. Annuities fall into the category of "confusing" because there are so many different types of annuities available. Annuities can be sold by banks, insurance agents, financial planners and security licensed sales people.

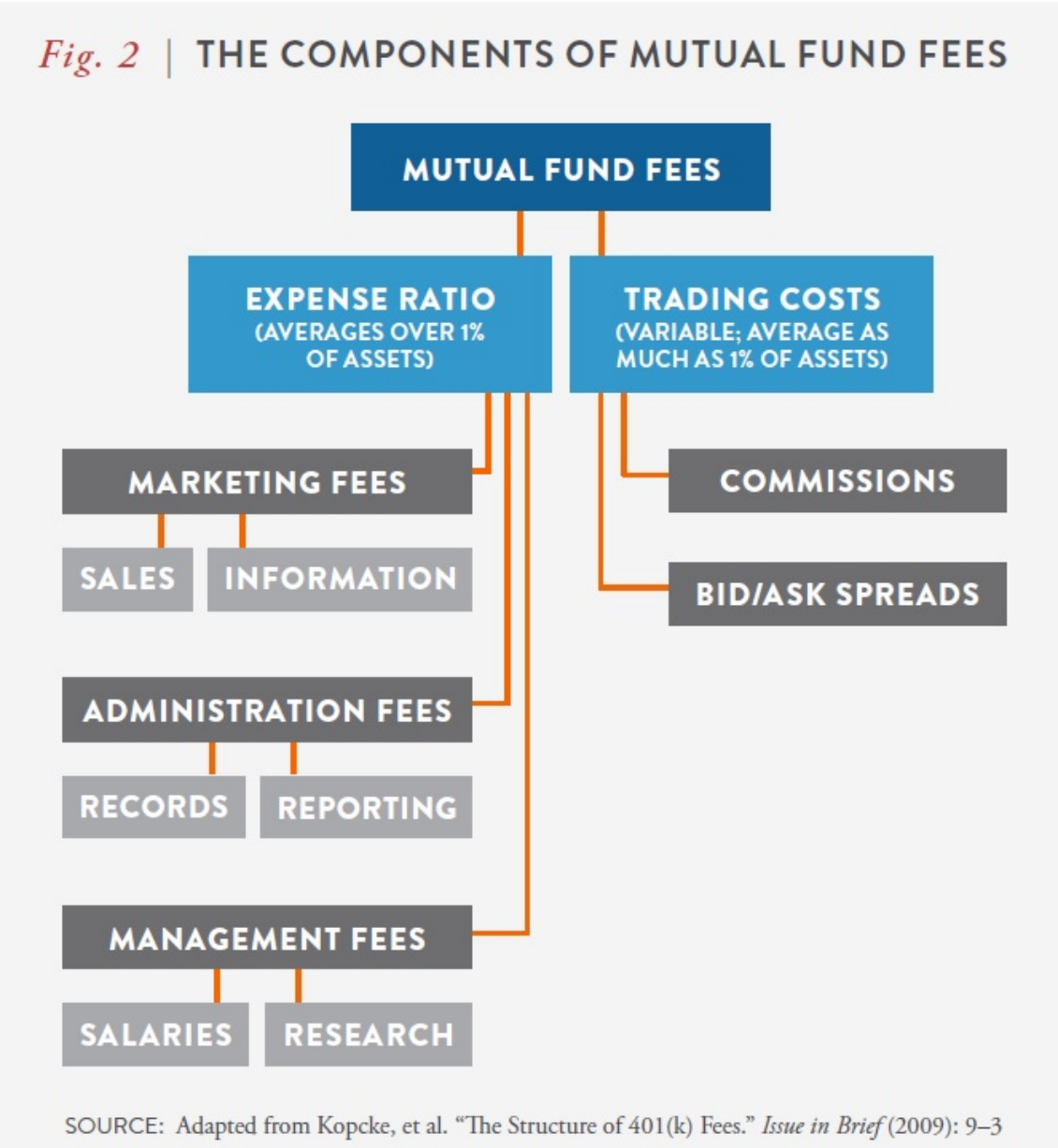
Annuities fall into one of two categories, those that are securities and those that are insurance products. The security type of annuity is called a variable annuity, in a variable annuity your funds are invested in mutual type products known as "sub-accounts". These accounts can increase and decrease based on market conditions and contains annual fees (based on the contract). Variable annuities have fees, fees for the contracts and fees for the money management. Make sure you fully understand them before deciding on purchasing an annuity.

A good source of information about variable annuities can be found from the industry overseer itself FINRA, link: http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance/p005976.

Fixed (or interest bearing annuities) are insurance products sold by licensed agents, these products are under the authority and regulation of each individual state insurance department. . A good source for fixed annuity information: www.annuity.com

See attached PDF 401k hidden costs

401(k) Fund Fee Breakdown



401 (k) Fees Breakdown

(agent use only, not for public info, please read entire report)

• Administrative fees:

Fund expenses for keeping records, providing statements, processing transactions, ensuring the plan complies with applicable regulations, answering savers' questions, and providing customer service. Administrative fees generally range from **0.2 percent to 0.4 percent annually.**

• Asset management fees:

Salaries for portfolio managers (who oversee different portions of a fund's assets), investment researchers, and the other employees responsible for fund's investments. Asset management fees generally range from **0.5 percent to 1 percent annually**.

• Marketing fees:

Also called 12b-1 fees, these include the expense of informing savers and potential savers about the mutual fund, including advertisements, brochures, and other informational material. Increasingly, mutual funds are lumping together a number of other costs under the umbrella of 12b-1 fees, including rebates to 401(k) "recordkeepers"—the companies that bundle various mutual funds into a 401(k) plan, sell it to employers, and then keep the records for the savers in the 401(k)s. **Marketing fees are limited to a maximum of 1 percent annually.**

• Trading fees:

The costs incurred by the fund when buying and selling the securities (bonds, stocks, etc.) that comprise a mutual fund's underlying assets. The reasons why mutual funds trade their assets are several, and summarized in the box below. Each mutual fund pays a commission to a securities broker each time it buys or sells a security, and it loses small amounts of money on "bid/ask spreads" that represent the difference between the actual buy or sell price for a security and its market value. In other words, if the fund wishes to sell a security, it generally must do so at a price that is slightly lower than its market value, and vice versa. If a mutual fund sells large blocks of a security, it must often do so at a progressively lower price, increasing costs. These **fees vary** from year to year depending on both the number of shares of a mutual fund bought and sold in a year, and on the frequency with which fund managers buy and sell the securities that comprise the underlying assets of the fund.

See attached PDF, FIA Presentation

Here is a good tip for a great source of information.
http://vsa.fsonline.com/

The Virtual Assistant

Everything you need to operate a financial practice at your fingertips.

Access from any computer
Available 24/7/365
Free 30 day trial period
No commitment
Only $23.95 per month
Full access to all tools & resources

Tons and tons of marketing and sales information, including numerous presentations.

I have enclosed the fixed indexed annuity presentation; open the pdf, the presentation can be completely personalized.

The simple fact that our industry attracted so many big investors so quick is a red flag to me....BB

http://nbr.com/2013/05/20/new-concerns-about-annuities/

New Concerns About Annuities

Now that some private equity firms are requiring or becoming involved in the annuity business, New York regulators are examining whether they are taking too many risks with investors` money.

Here is a recent blog that makes a great sales piece....use this opening line to gain interest with your prospect....

"Mrs. Jones, if I could show you how you can receive guaranteed income, save for your future and protect yourself against inflation all at the same time, would you have an interest in learning more?"

Considering "Splitting" Your IRA for Maximum Opportunity

How can a 65 year person with $500,000 in an IRA earn guaranteed income, save for the future and protect themselves against inflation all at the same time?

The simple answer is yes, you can "split" the IRA account, use a portion for income (as example) for 10 years at which time it would end, then defer the second $250,000 for 10 years and convert it to income at that time.

This concept is called the **Split Annuity** and is perfect for a person who wants income now but wants to build a larger income in the future as a hedge against inflation.

With the **Split Annuity** in this case I used 50% of the $500,000 and bought an immediate annuity with a company that provides the best

guaranteed for 10 years. The immediate annuity provides an estimated $26,729 a year of guaranteed income for 10 years.

With the other half of the IRA I made a deposit into a **Fixed Index Annuity** with an income rider that provides a guaranteed 8% bonus on the $250k and this amount grows at 6.50% each year for 10years. (when used as income) When the first half of the split annuity ends in 10 years, you can start the income form the second annuity. This income stream can pay for any time period, even lifetime and a spouse can be included. A reasonable estimate from the deferred income could be in excess of $30,000 for lifetime income.

Plus, any unused funds on deposit in the annuity, in the event of a premature death, are passed to the named beneficiary.

Here are the advantages of using the split annuity concept.

- Income now and income deferred.
- Current and future income is fully guaranteed.
- Required minimum withdrawals are included in the annuity income

The split annuity is just another example of how creative and flexible an annuity can be in helping you meet your income goals!

John Hancock LTC premium increase of 20%, thanks Jim Grazioli for the share.

North Palm Beach, FL 33408-5205

Ref: Notice of Premium Rate Increase -- Long-Term Care Insurance Policy No. **Decision required by April 20, 2013.** John Hancock Life Insurance Company (U.S.A.)

Dear

We are writing to notify you about an increase to your long-term care (LTC) insurance premiums.

At John Hancock, our commitment is to ensure LTC insurance benefits will be there for our policyholders when they need them most. To uphold this responsibility, we continuously monitor the experience of our inforce LTC insurance policies. After the most recent detailed analysis of our business, we have determined there is a need to increase premiums on certain policy series to reflect the future claims expected on these policies, and yours is one of those policies affected.

Options to Minimize the Premium Increase
We sincerely regret having to take this action, and understand some policyholders may not be willing or able to pay the higher premium. Therefore, at this time, we are offering you personalized options that enable you to minimize the current premium increase by reducing your coverage. Please refer to the enclosed "Options Package" for more information.

About the Premium Increase
Based on your current benefit selections, your premiums will increase from $794.61 to $953.53, annually. This change represents a 20% increase in your premium. This new premium will be effective for premiums due on or after May 20, 2013. Please note this letter is not a bill.

We do want you to know that, based on the detailed analysis of our business, we had determined there was a need for a 41.67% increase and this was the amount we filed with the Florida Insurance Department. However, the rate increase we are authorized to implement at this time is 20%. As a result, we anticipate that we will be requesting further premium increases in your state in the future, and your policy premiums may be affected.

Continued on next page

LTC Insurance could be vital to many, look at this:

The cost of assisted living or nursing home care alone could motivate you to pay the premiums. Genworth Financial conducts a respected annual Cost of Care Survey to gauge the price of long term care in the U.S. **Here is a summary of the 2013 survey's key findings:**

*In 2013, the median annual cost of a private room in a nursing home was $83,950 or **$230 per day** – up 3.6% from 2012. In the past five years, the cost has risen about 4.5% annually.

*A private one-bedroom unit in an assisted living facility has a median cost of $3,450 a month, or $41,400 annually. It was 4.5% cheaper last year.

*The median payment to a non-Medicare certified, state-licensed home health aide is $19 an hour in 2013, up 2.3% from 2012.[1]

The U.S. Department of Health & Human Services estimates that about **70% of Americans** will need some kind of long term care during their lifetimes.

Additionally, **69% of Americans older than 90** have some form of disability – often a direct cause for long term care.[2]

http://business.time.com/2013/05/13/the-new-retirement-forget-being-rich-all-we-want-is-peace-of-mind/#ixzz2UEYXfYHP

The New Retirement: Forget Being Rich, All We Want Is Peace of Mind

This experience goes a long ways toward explaining boomers' new priorities. By a margin of 7 to 1, adults past the age of 45 say their focus

today is on peace of mind — not wealth accumulation, according to a new retirement study from Merrill Lynch and Age Wave.

Long gone is the prerecession attitude of taking risks and building the biggest portfolio possible. Today's new retirees and pre-retirees crave the **peace of mind that comes from having enough money safely** tucked away to provide a sufficient and dependable income stream. In the survey, guaranteed income and protecting assets were four times more important than achieving high-risk returns.

This is why sales of **fixed annuities** are exploding and **guaranteed lifetime income products** are the new subject du jour. Today's retirees don't need a stockpile to count so much as predictable income so that they can spend time with family and on experiences and pursue new, if modest, passions.

Read more: http://business.time.com/2013/05/13/the-new-retirement-forget-being-rich-all-we-want-is-peace-of-mind/#ixzz2UWsyPAIe

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Be careful when using your off week drip, make sure it is to your opt in database, NEVER email to a mailing list.....BB

Can you imagine dealing with everything it takes to sell variable annuities? It would be the opposite of a "hassle" free existence....BB

http://www.lifehealthpro.com/2013/05/20/variable-annuities-getting-more-variable?t=annuity-sales-strategies

Variable annuities getting more variable

Product changes in variable annuities are coming fast and furious as carriers attempt to cope with low interest rates by raising fees and scaling

back features. Advisors, meanwhile, have their work cut out for them as they analyze all the new twists and turns in product offerings.

http://www.investmentnews.com/article/20130526/REG/305269982?utm_source=issuealert-20130526&utm_medium=in-newsletter&utm_campaign=investmentnews&utm_term=text

I put the entire article from Dan Jamieson in the notes, also the link is above. I have made some remarks in (parenthesis) and highlight a few important points in **red**....BB

FINRA going all out to control email

By **Dan Jamieson**
May 26, 2013 @ 3:31 pm (Updated 9:33 am) EST

The **$7.5 million fine** against **LPL Financial** LLC last week for **e-mail violations** is noteworthy for its size — it is the largest ever brought by Finra exclusively for e-mail violations — but a review by *InvestmentNews* shows that it is just the latest example of the regulator's stepped-up enforcement effort in this area.

Furthermore, brokers and their firms will **continue to be targets of disciplinary** actions for failing to retain and review business-related e-mails, especially where fast growth and increased regulatory requirements overtake stretched compliance resources, legal sources said. **(states might consider this at some date for insurance agents....BB)**

In settling the case against LPL, the **Financial Industry Regulatory Authority** Inc. said that as the firm "rapidly grew its business, [it] failed to devote sufficient resources to update its e-mail system, which became increasingly complex and unwieldy."

Finra said the firm had numerous systemic failures that prevented access to hundreds of millions of e-mails from 2007 to 2013.

Finra also said the firm made material misstatements during its investigation.

“Fast-growing firms and systems are always a challenge,” said Finra enforcement chief Brad Bennett. “Compliance and legal [departments] are being asked to do more with the same resources.”

LPL, which has 13,000 registered representatives and financial advisers, had its initial public offering in 2010 after a decade of rapid growth.

The firm neither admitted to nor denied the charges.

“In September 2011, we reported to Finra issues relating to the surveillance and retention of e-mails,” LPL said in a statement. “We cooperated fully with Finra throughout its ensuing investigation. We very much regret our lapse of oversight.”

The firm has “undertaken a comprehensive redesign of our e-mail systems, and associated compliance policies and procedures,” the statement said.

E-mail enforcement actions are rising along with the use of e-mail. A review of Finra e-mail cases by *InvestmentNews* uncovered nine settlements with broker-dealers year-to-date, not including the LPL case. The total fines amounted to $1.65 million. E-mail violations either were the only ones cited or appeared to make up a major part of these cases.

In all of last year, in comparison, Finra settled 18 such cases for a total of $1.24 million.

Finra often combines various charges in one case, so separating them into unique e-mail cases is somewhat subjective.

A separate study by the law firm Sutherland Asbill & Brennan LLP found a sharp increase in e-mail-related violations last year. The law firm said Finra fines shot up to $6.5 million in 2012, an increase of 81% from the prior year. It counted 63 e-mail cases in 2012, up from 57 cases in 2011. Sutherland included all cases where e-mail violations were part of the case, regardless of how minor**. (law firms looking into this is always a eye brow raiser, why? Could it be a large lawsuit being plannee?....Bb)**

In one of the noteworthy cases this year, **Next Financial Group Inc.** this month agreed to pay Finra a $250,000 fine to settle an e-mail case. **Securities America Inc.** consented to a $100,000 fine in April, and in February, five broker-dealers owned by ING Groep NV settled an e-mail case for $1.2 million.

“There will always be e-mail cases as long as people in the industry are using it,” Mr. Bennett said.

Securities and Exchange Commission and Finra rules require broker-dealers to establish written procedures and systems to capture and retain for **three years all e-mail communications** to the public. Firms either must pre-approve or regularly review at least a sample of e-mails sent by brokers to customers.

TECHNOLOGY STRUGGLE

Firms and brokers often struggle with the technology used for retaining e-mails, and glitches can occur that compliance officials may not be aware of. Also, individual brokers may fail to inform their B-Ds about using outside or personal e-mail. **(just what part of your life is not open to FINRA?....BB)**

Finra is especially concerned when failure to retain e-mails might have prejudiced regulators or arbitration claimants, Daniel Nathan, a partner at Morrison & Foerster LLP, wrote in an e-mail.

The LPL settlement requires the firm to put $1.5 million into a fund to pay customer claimants for potential discovery failures. Investors who filed claims as of Jan. 1, 2007, and whose cases were closed by Dec. 17, 2012, will get a standard $3,000. Alternatively, they can ask a fund administrator to approve up to $20,000.

“I'm going for the $20,000, absolutely,” said Andrew Stoltmann, founder of the Stoltmann Law Offices PC. He's filed about 50 cases against LPL in the last five years and thinks the amounts offered in the settlement aren't enough.

Mr. Bennett countered that the deal is “more than enough,” based on a 2007 settlement with Morgan Stanley that went far beyond a simple e-mail case. The wirehouse agreed to pay $12.5 million to resolve Finra charges that it failed to provide e-mails to arbitration claimants and regulators by claiming the 9/11 terrorist attacks had destroyed all pre-9/11 e-mails. In fact, the firm had retained or restored millions of pre-9/11 e-mails, Finra said at the time.

“We found most [Morgan Stanley claimants] were happy with the standard payout,” Mr. Bennett said.

Bruce Kelly and Mark Schoeff Jr. contributed to this story.

Dan Jamieson

The commercials are now in hi def, FIA is almost ready.

Meet Katrina Pearson, your new Annuity.com spokesperson, our second instructional vehicle is in the can and will be ready an a week,

Fixed Indexed Annuities.

See her at our new **"annuitycom"** channel on **YouTube**

http://www.youtube.com/watch?v=h89BIToyQJA

Stock Market Blues in HD:
http://www.youtube.com/watch?v=HuGRBhJ1RAE

Safe Man in HD:
http://www.youtube.com/watch?v=Ru11UGE_FC4

How would you like to use this (and 6 others) for direct marketing to your database? It will soon be an available marketing option for you....just another way to find the prospect!

Let's get the update on our new lead pricing and lead flow from Kevin

We spoke about our lead price change, it is now active....BB

Lead Changes….Effective May 21

- **Price Reduction**
- **Added Benefits**
- **Quality Improvements**
- **More Leads**

We have a big change in our lead system and improved pricing.

First of all thank you all very much for being so patient, leads are now flowing and we can begin to provide you with enough lead flow to make a difference in your marketing.

A word of advice, never depend on just one source for leads, *it takes a village to raise an annuity agent!* Use several sources to help balance out your marketing needs. *(Don't forget our life leads, call Shaun for info)*

We have always attempted to price our leads at cost, none of us have ever looked at our lead system as an income center, instead we consider it an aid to agents and to help us all sell more annuities.

That said, we do have a change in our approach and our pricing.

Our focus is on scrubbed leads, leads that we have talked to the prospect, ascertained their interest level, obtaining for you the highest possible leads we can. We make sure they are actual annuity prospects, their annuity interest level, and their timeline, the amount they are interested in investing and if they are willing to speak to an agent. Any lead we speak to who will not talk to an agent is dumped, thrown away.

100% of all leads are phone verified!

Plus the **HOOK**, we always look for the hook for you.

This system is an entirely outsourced system for you. This is an expensive and thorough process, but we are 100% committed to providing. Our crew price for scrubbed leads is $165; you must get this pricing code through your marketing advisor, Joe, Anthony, Chad, David or me.

If you are only interested in leads and have no interest in our crew approach, the price is $195. The exact process for scrubbing is the same; we are offering the leads at our cost basis for those writing with us.

Here is the change.

$59

Our premium (branded Annuity.com) leads will be lowered to **$59** for crew members. Yes, I did say **$59**. Here are some of the features for our branded and premium leads:

- Exclusive, as always, our leads are only sold once
- Data verified, address, zip code etc.
- Phone verified

- All leads flow through our website, landing pages or marketing logo.

Q. Why don't we just scrub them all? Simple, lead flow is dependent on lead movement, leads have to come in and go out. If we cannot reach the prospect by phone in 0ne hour, they automatically flow to the $59 lead.

We do not queue up our leads for future calling; they are called and moved on either scrubbed or non-scrubbed.

These are the same leads we scrub for you. The good news is they are growing in volume and we can help you with more leads.

If you are not writing business with us, the price is $65 per lead.

How can we sell them so cheap? Our marketing is expanding and we manage our costs.

Is there a catch? Yes and no.

In some areas we may require you purchase leads a little further from your desired marketing area, not in all cases, but in some. Kevin and Allison can help with these details.

We have written new software to minimize this for you, but during the changeover there could be a few leads a little further than you might wish to market. But at $59 for exclusive annuity.com branded leads, cheap! You may have to work a few my phone, so????

Crew: $165 we scrub, $59 you scrub.

Non Crew: $195 we scrub, $65 you scrub.

As always, in areas where we have a crew member using leads, they have priority over non crew.

Plus, there is more. In the next few months, the geographic area you choose will be refined, so that your marketing needs are better matched up with our lead delivery. Lots of new refinements and new additions planned.

Retire Village Changes: Also included in the lead system changes is this, if you wish and you are a member of Retire Village, the leads flow automatically to your database, so even a lead who may not wish to purchase an annuity today will be kept warm for you. (see Joe Rych for details).

Generate Leads and Sales with Our
Spaced Repetition
Drip System

I learned the True Value of Spaced Repetition

from my daughter.....

DADDY, DADDY, DADDY, DADDY, DADDY .... You get the picture....

We Recommend:

Spots are running.....leads....sign up!

Here is the YouTube link:

http://www.youtube.com/watch?v=sGQToDarklU

Scrubbed Leads Description

We offer leads who have previously responded to financial advertisements such as TV or the internet, these leads area attacked due to the message and our brand, Annuity.com. In other words, we know that the lead has inquired about annuity or other financial products.

When a lead is scrubbed the prospect is given the name of the agent who will be contacting them. The type of data that is collected for the agent is the following:

- The prospect is given your name
- The type of annuity they are interested in
- The amount & location of their money to invest
- Their time frame for a potential annuity investment
- The best time they can be reached by phone
- Any additional information / notes we are able to gather...

Leads are delivered in real time.

Lead Volume test ~ Each area is individually tested so that we can reasonably predict the number of leads you should receive. Until your area is tested you may receive more leads than you expect.

Leads are then distributed on a round robin basis if there is more than one agent signed up for leads in your area with producing agents having priority.

The travel distance to the lead address is determined by the geographical broadcast area of the TV or Radio station. However, the majority of the leads will be within the highest density population areas.

You can sign up for leads at: Sign up for leads at:

http://www.annuity-admin.com/agents/index.php

www.annuity.com/agenttools

If you are not using this "Free" resource you are missing out....did I mention it is free?

There is a ton of info here, it requires no password and it is up to date information.

Disclaimer:

My opinion or numerous sources complied by me

I obtain information from many sources, print, internet, agent gossip and other media. I always try and provide the original source or the link but my note taking habitually is lacking.

Much of the content on Open MIC is written by me and is my personal opinion. You should never consider that I am the world's greatest authority or expert on anything. Always consult professionals who are licensed to give correct advice regarding taxes and securities and other topics of great importance.

I am an authority in lead generation and marketing annuities and am fully licensed as an insurance salesman. I sell state approved annuity products provided by licensed insurance companies.

I am also NOT an economist by license, only by hobby. If you decide to make decisions based on my particular view of the world, you should get it verified by licensed professionals or get your head examined.

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Our competitors will copy Open MIC anyway so I might just as well give it away, saves so much mental anguish and sleepless nights.

More Legal Stuff...

Be responsible... we cannot know your individual situation, always do your own due diligence before responding to any offer or investing any money.

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We make no compensation for the publishing (or hosting) of Open MIC Notes.....in fact it costs us for the phone "call in" system...oh well...

Understanding Annuities:
A Lesson in Fixed Interest and Indexed Annuities

Did you know that an annuity can be used to systematically accumulate money for retirement purposes, as well as to guarantee a retirement income that you cannot outlive?

Prepared for:

Brought to you by:

Bill Broich
McGavick Broich
PO Box 14571
Olympia, WA 98511
Office: (360) 701-6209
bbroich@msn.com
http://finsecurity.com/galic42

May 28, 2013

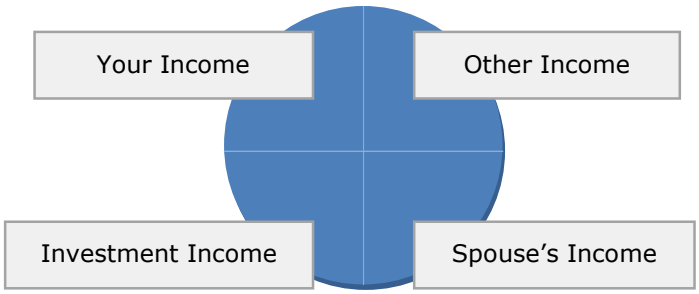
Table of Contents **Page**

Your Earning Power

Your earning power – *your ability to earn an income* – is your most valuable asset.

Few people realize that a 30-year-old couple will earn 3.5 million dollars by age 65 if their total family income averages $100,000 for their entire careers, without any raises.

Earning Power:



How Much Will You Earn in a Lifetime?

Years to Age 65	Your Future Earning Power If Your Family Income Averages:			
	$50,000	$100,000	$250,000	$500,000
40	$2,000,000	$4,000,000	$10,000,000	$20,000,000
35	1,750,000	3,500,000	8,750,000	17,500,000
30	1,500,000	3,000,000	7,500,000	15,000,000
25	1,250,000	2,500,000	6,250,000	12,500,000
20	1,000,000	2,000,000	5,000,000	10,000,000
15	750,000	1,500,000	3,750,000	7,500,000
10	500,000	1,000,000	2,500,000	5,000,000
5	250,000	500,000	1,250,000	2,500,000

How much of this money will be available to you when you retire?
How can you systematically accumulate money for retirement?
How can you guarantee a retirement income that you cannot outlive?

Annuity Objectives

In planning for financial security in retirement, an annuity can help satisfy two basic objectives:

To accumulate retirement assets on a tax-deferred basis.

If you're already contributing the maximum to IRAs and any employer-sponsored retirement plans and need to save more for retirement, a deferred annuity may be the answer to your retirement savings need.

To convert retirement assets into an income that you cannot outlive.

On the other hand, if you're near or at retirement, an immediate income annuity can be used to convert existing retirement assets into a lifetime income.

What Is an Annuity?

An annuity is a long-term savings plan that can be used to accumulate assets on a tax-deferred basis for retirement and/or to convert retirement assets into a stream of income.

While both are insurance contracts, an annuity is the opposite of life insurance:

- **Life insurance** provides financial protection against the risk of dying prematurely.
- **An annuity** provides financial protection against the risk of living too long and being without income during retirement.

Annuities are classified in several different ways, including:

- **When annuity payments begin**
- **How premiums are paid**
- **How annuity premiums are invested**

If you are already contributing the maximum to an IRA and/or an employer-sponsored retirement plan, an annuity can be an excellent way to save for financial security in retirement.

Deferred Annuities vs. Immediate Annuities

When Annuity Payments Begin…

Deferred Annuities vs. Immediate Annuities

1. Deferred Annuities

- A deferred annuity has two distinct phases: the **accumulation or savings phase** and the **income phase**.
- During the **accumulation or savings phase**, annuity premiums, less any applicable charges, accumulate in the contract on a tax-deferred basis until the annuity starting date. Deferral of tax on annuity earnings is a major advantage that other non-qualified financial products cannot provide.
- On the annuity starting date, a deferred annuity enters the **income phase**, at which time the value of the annuity is converted into a stream of income.

2. Immediate Annuities

- An immediate annuity has only one phase: the **income phase**.
- The single premium used to purchase an immediate annuity is converted into a stream of income **immediately** or shortly after the date the annuity is purchased.

Installment Premium Annuities vs. Single Premium Annuities

How Premiums Are Paid…

Installment Premium Annuities vs. Single Premium Annuities

1. Installment Premium Annuities

- The annuity premium is paid in installments to the insurance company over a period of time.
- The installment premiums can be either a **fixed**, scheduled amount or can be **flexible**, meaning that the amount paid can vary (within set contract limits).
- During the **accumulation or savings period** prior to retirement, installment premiums, less any applicable charges, accumulate in the contract on a tax-deferred basis until the annuity starting date
- On the **annuity starting date**, the value of the annuity can be converted into a stream of income.

2. Single Premium Annuities

- The annuity is purchased with a single premium payment.
- A **single premium deferred annuity** has an accumulation period prior to retirement, during which the single premium, less any applicable charges, accumulates in the contract on a tax-deferred basis until the annuity starting date, when the annuity value can be converted into a stream of income.
- In the case of a **single premium immediate annuity**, the single premium, less any applicable charges, is converted into a stream of income immediately or shortly after the date of purchase.

Fixed Interest Annuities vs. Indexed Annuities

How Annuity Premiums Are Invested…

Fixed Interest Annuities vs. Indexed Annuities

1. Fixed Interest Annuities

A fixed interest annuity pays a **fixed rate of interest** on the premiums invested in the contract, less any applicable charges. The insurance company guarantees* that it will pay a **minimum interest rate** for the life of the annuity contract. A company may also pay an "excess" or bonus interest rate, which is guaranteed* for a shorter period, such as one year.

2. Indexed Annuities

An indexed annuity has characteristics of both a fixed interest annuity and a variable annuity. Similar to a **variable annuity**, the insurance company pays a rate of return on annuity premiums that is tied to a stock market index, such as the Standard & Poor's 500 Composite Stock Price Index. Similar to **fixed interest annuities**, indexed annuities also provide a minimum guaranteed interest rate*, meaning that they have less risk of loss of principal than variable annuities. An investment in an indexed annuity is not a stock market investment. Instead, the rate of return is linked to the performance of a market index that tracks the performance of a specific group of stocks. Since the minimum guaranteed interest rate is combined with this interest rate linked to a market index, indexed annuities have the potential to earn returns better than fixed interest annuities when the stock market is rising. You could, however, lose money on your investment if the issuing company does not guarantee 100% of the principal and you receive no index-linked interest due to a decline in the market index linked to your annuity, or if you surrender your indexed annuity while a surrender charge is in effect.

** All guarantees are based on the claims-paying ability of the issuing insurance company.*

A Closer Look at Fixed Interest Annuities

Deferred Fixed Interest Annuities:

Premium Payments: A deferred fixed interest annuity can be purchased either with a single premium or through a series of installment premiums.

Accumulation Phase: During the accumulation phase, the insurance company pays a fixed rate of interest on the premiums invested in the contract, less any applicable charges. The fixed interest rate paid is determined by the insurance company and is spelled out in the annuity contract. While the insurance company guarantees* that it will pay a minimum interest rate for the life of the annuity contract, a company may also pay an "excess" or bonus interest rate, which is guaranteed* for a shorter period, such as one year.

Income Phase: On the annuity starting date, you can elect to receive the value of the annuity in a single lump sum or you can select from a variety of annuity income options, some of which guarantee* you a fixed, level income that you cannot outlive.

Immediate Fixed Annuities:

Premium Payments: An immediate fixed annuity can be purchased with a single premium only.

Income Phase: The single premium less any applicable charges is converted into a guaranteed* fixed, level income that begins immediately or shortly after the premium is paid.

** All guarantees are based on the claims-paying ability of the issuing insurance company.*

A Hybrid Annuity…Equity-Indexed or Indexed Annuities

The indexed annuity has features of both a fixed interest annuity and a variable annuity:

- The insurance company pays a rate of return on your annuity premiums (less any applicable charges) that is tied to a stock market index, such as the Standard & Poor's 500 Composite Stock Price Index.

- Similar to a **fixed interest annuity**, an indexed annuity also provides a minimum guaranteed* interest rate. Unlike a fixed interest annuity, many indexed annuities only guarantee that you'll receive 87.5% of the premiums you paid. In addition, early surrender of any annuity can result in loss of some principal and/or interest earnings.

An indexed annuity is an insurance contract and not an investment in the stock market. Indexed annuities credit interest using a formula based on changes in the index to which the annuity is linked. Any interest payable in excess of the minimum guaranteed* interest rate is determined by a formula contained in the annuity contract. This formula is determined by a variety of indexed annuity contract features, including:

- **Indexing Method:** There are different methods used to determine the change in the relevant index over the period of the annuity. The indexing method used will impact the amount of interest credited to the contract.

- **Participation Rates:** How much of the gain in the index will be credited to the indexed annuity? If, for example, an indexed annuity has an 80% participation rate, the annuity will be credited with only 80% of any gain experienced by the index.

- **Spread/Margin/Asset Fee:** An indexed annuity may contain a spread/ margin/asset fee instead of, or in addition to, a participation rate. If, for example, an indexed annuity has a 3% spread/margin/asset fee and the index gains 9%, the interest credited to the annuity will be 6%.

- **Interest Rate Caps:** Some indexed annuities contain a cap or upper limit on the amount of interest the annuity will earn. For example, if the cap rate is 10% and the index linked to the annuity gains 12%, only 10% will be credited to the annuity.

* *All guarantees are based on the claims-paying ability of the issuing insurance company.*

Fixed Annuity Suitability

First of all, an annuity should be considered as a longer-term investment. If, for example, your objective is to save for retirement and you are already contributing the maximum to an IRA and/or employer-sponsored retirement plan, an annuity might be right for you. But which type of annuity? The answer to that question depends primarily on your investment objectives and risk tolerance.

Fixed interest annuities may be best suited for individuals who:

- Prefer to rely on fixed rates of return
- Focus on preservation of assets
- Want protection from market volatility
- Prefer to delegate investment decisions and risks to the insurance company
- Understand that a fixed rate of return may not provide a good hedge against inflation

Indexed annuities may be best suited for individuals who:

- Are adverse to risk
- Understand that a rate of return linked to stock market performance provides the potential for higher returns than fixed interest investments, together with the risk of losing money if the issuing company does not guarantee 100% of the principal and no index-linked interest is credited, or if the indexed annuity is surrendered while a surrender charge is in effect
- Prefer to delegate investment decisions to others
- Want less market risk than with a variable annuity

Annuity Comparisons

Fixed Interest Annuities vs. Indexed Annuities

	Fixed Interest Annuities	Indexed Annuities
Minimum guaranteed return?	Yes [1]	Yes [1]
Choice of investment options?	No	No
Opportunity to earn a higher return?	No	Yes
Possibility of losing principal?	No [1]	Maybe [2]
Tax-deferred growth?	Yes	Yes
Minimum death benefit?	Yes [1]	Yes [1]

[1] Subject to the claims-paying ability of the issuing insurance company.

[2] It is possible to lose principal in an indexed annuity if, for example, the issuing insurance company does not guarantee 100% of the principal and no index-linked interest is credited to the contract because the index linked to the annuity declines, or if an indexed annuity is surrendered while a surrender charge is in effect.

Immediate Annuities vs. Deferred Annuities

	Immediate Annuities	Deferred Annuities
Premium payments?	Single premium only.	Either a single premium or a series of installment premiums.
Annuity payout?	Begins immediately or shortly after premium is paid.	Begins at a future annuity payout date, providing time for annuity accumulation.
Partial withdrawals?	Possibly; review the features of the contract you are considering to determine if withdrawals may be made and under what conditions.	Yes, subject to the terms of the contract and possible charges, partial withdrawals can be made from a deferred annuity; partial withdrawals may be subject to a premature withdrawal tax if made prior to age 59-1/2. Withdrawals will reduce the value of the death benefit and any optional benefits.
Surrender value?	None; the contract cannot be surrendered.	Yes, a deferred annuity can be surrendered for its value, subject to surrender charges and a possible premature withdrawal tax if surrendered prior to age 59-1/2.

Annuity Income Phase

When you are ready to begin receiving income from a deferred annuity, you can select from a variety of options, including:

Lump Sum Distribution

You can surrender your deferred annuity and receive the entire value in a lump sum payment. This option requires that income tax be paid on the annuity earnings in the year you receive them. In addition, a lump sum distribution does not solve the problem of outliving your retirement income.

Systematic Withdrawals

You can set up a systematic withdrawal plan, through which you receive a specified amount of money at regular intervals, such as $1,000 per month, until all assets have been withdrawn. With this option, you have the flexibility to change the payment schedule in the future. Since, for income tax purposes, earnings are considered withdrawn before principal, the likelihood is that the earlier withdrawals will be fully taxed at ordinary income tax rates. In addition, with this option there is no guarantee that you will not outlive your retirement income.

NOTE: A lump sum distribution or systematic withdrawals made prior to age 59-1/2 may be subject to a 10% federal tax penalty on the taxable amount of earnings withdrawn, unless one of the exceptions is met.

Annuitization

You convert the value of your deferred annuity into a lifetime income or into a stream of payments for a fixed period of time. Alternatively, you use other retirement assets to purchase an immediate income annuity. As reviewed on page 13, there are a variety of annuity income options from which to select.

Other Options

Talk to your licensed financial adviser about other options that may be available in the annuity contract you are considering.

Annuity Income Options

At retirement, annuity income can be structured in a variety of ways, enabling you to select the income option that best satisfies your unique needs. While you can surrender a deferred annuity and receive a **lump-sum payment** equal to the annuity value, many people elect to convert the annuity value into a stream of retirement income using one of these income options:

Life Income Option

- Payments are made for as long as the annuitant is alive.
- Payments cease at the annuitant's death.
- This option produces the maximum guaranteed* lifetime income.

Life Income with Period Certain Option

- Payments are made for as long as the annuitant is alive.
- If the annuitant dies before a specified number of payments have been received (e.g., 120 monthly payments), the remaining payments in the period certain are made to the beneficiary.

Life Income with Refund Guarantee Option

- Payments are made for as long as the annuitant is alive.
- If the annuitant dies before payments equal to all or a specified portion of the purchase price have been received, the beneficiary receives the balance of the payments, up to the refund guarantee* amount.

Joint-and-Survivor Option

- This payout option covers two lives.
- The same payment can be received for as long as either of the two annuitants is alive or, alternatively, at the death of the first annuitant, the payment to the surviving annuitant can be structured to reduce to a specified percentage (e.g., 75%) of the payment received while both annuitants were alive.
- A joint-and-survivor payout can also include a period certain feature.

Period Certain Option

(no guarantee of lifetime income)

- Payments are made for a specified number of years, such as 10 years or 20 years.
- Payments cease at the end of the period certain.
- If annuitant dies before receiving all guaranteed* payments, the beneficiary will receive the remaining payments.

* All guarantees are based on the claims-paying ability of the issuing company.

Flexibility

While these are the five basic annuity income options, some annuity contracts offer additional flexibility…ask your licensed financial adviser about contract features that may add flexibility to your use of an annuity to provide retirement income.

Non-Qualified Annuity Taxation

During the Accumulation Phase:

- Earnings credited on the funds in a deferred annuity are tax deferred, meaning that the earnings are not taxed while they remain in the annuity.
- Withdrawals from a deferred annuity during the accumulation phase are treated as withdrawals of earnings to the extent that the cash value of the annuity exceeds the total premiums paid and are taxed as income in the year withdrawn. To the extent that a withdrawal exceeds any earnings, that portion of the withdrawal is considered a non-taxable return of principal.
- In addition, a 10% penalty tax may be imposed on withdrawals made before age 59-1/2, unless certain conditions are met. The penalty tax is in addition to the regular income tax on the withdrawal.
- If the annuitant dies during the accumulation phase, the value of the deferred annuity is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

During the Income Phase:

- The annuity purchase price is returned in equal income-tax-free amounts over the expected payment period (based on the annuitant's life expectancy).
- The portion of each payment in excess of the tax-free return of the purchase price is taxable in the year received.
- In summary, a portion of each annuity payment is received income tax free and the balance is taxable as received.
- At the annuitant's death, the present value of any remaining annuity payments due is generally included in the annuitant's estate, to the extent of the deceased annuitant's proportional contribution to the annuity purchase price.

A professional tax advisor should be consulted for more detailed information on annuity taxation in your situation.

Fixed Annuity Advantages and Disadvantages

An annuity can be a great way to save for retirement on a tax-deferred basis, in effect creating your own personal "pension" plan. As with any investment, however, there are also potential disadvantages that should be evaluated before purchasing an annuity.

Advantages:

- A fixed annuity protects against a decline in asset value during market downturns.
- Earnings on your annuity premiums are tax deferred so long as they remain in the annuity. When compared to an investment whose earnings are taxed each year, tax deferral offers the potential for accumulating significantly higher amounts of money over time.
- An annuity can be used to provide a steady source of retirement income that you cannot outlive.
- Unlike an IRA or employer-sponsored retirement plan, there are no annual contribution limits to an annuity…you can contribute as much as you want.
- Subject to the terms of the contract, there is no required date by which you must begin receiving annuity income payments, providing you with the flexibility to defer payments until you need the income.
- If you die while your annuity still has value, the annuity death benefit passes directly to your beneficiary without probate.
- In most states, an annuity is free from the claims of a creditor.

Disadvantages:

- The growth of a fixed annuity may not keep pace with inflation.
- Premiums for a non-qualified annuity are not tax deductible, meaning that they are made with after-tax dollars.
- While you can surrender or make withdrawals from a deferred annuity before you begin receiving income payments, the surrender or withdrawal may be subject to a charge if made within a stated number of years after the annuity is initially purchased.
- If made prior to age 59-1/2, a surrender or withdrawal will be subject to a 10% federal penalty tax unless one of the exceptions to this tax is met.
- When received, investment gains are subject to ordinary income tax rates and not the lower capital gains tax rate.
- Once annuity income payments begin, annuity contracts vary in regard to whether the payment amount can be changed and/or whether amounts can be withdrawn from the contract. Ask your licensed financial adviser to explain whether the contract you are considering allows for annuity payments to be increased or decreased and whether withdrawals are available.

Fixed Annuity Checklist

Once you decide that an annuity is right for you, there are a number of factors you should consider in evaluating the specific annuity you will purchase. These include:

Fees and Expenses

The annuity fees and expenses an insurance company charges can include:

- **Premium charges** deducted when premiums are paid;
- An **annual maintenance fee** (e.g., $30);
- **Mortality or insurance charges** for death benefit features; and/or
- **Surrender charges** assessed when the annuity is surrendered or withdrawals are made in the early years of the contract.

Carefully evaluate fees and expenses, since they will impact the amount of money ultimately available in the annuity.

Insurance Company Ratings

Since an annuity is an insurance contract, you need to be able to count on the financial strength and claims-paying ability of the insurance company from which you purchase an annuity. Ask for company rating information from respected sources, such as A.M. Best, Moody's or Standard & Poor's, before purchasing an annuity.

Annuity Features

Make sure you understand the terms and limitations of the annuity contract before you purchase it, including:

- In the case of a **fixed interest annuity**, the current interest rate being credited, how often it changes and the minimum interest rate guaranteed by the contract;
- in the case of an **indexed annuity**, how amounts credited to the annuity contract are determined;
- the withdrawal and surrender options;
- how the death benefit is determined and paid;
- the income payout options available.

Important Information

The information, general principles and conclusions presented in this report are subject to local, state and federal laws and regulations, court cases and any revisions of same. While every care has been taken in the preparation of this report, neither VSA, L.P. nor The National Underwriter Company is engaged in providing legal, accounting, financial or other professional services. This report should not be used as a substitute for the professional advice of an attorney, accountant, or other qualified professional.

Annuity contracts contain exclusions, limitations, reductions of benefits and terms for keeping them in force. All contract guarantees are based on the claims-paying ability of the issuing insurance company. Consult with your licensed financial representative on how specific annuity contracts may work for you in your particular situation. Your licensed financial representative will also provide you with costs and complete details about specific annuity contracts recommended to meet your specific needs and financial objectives.

NOTE: This annuity discussion is intended primarily to provide information on personal, non-qualified annuities that are not purchased to fund an IRA or qualified employer-sponsored retirement plan. An annuity purchased to fund an IRA or qualified employer-sponsored retirement plan does not provide any additional tax deferral, since tax deferral is provided by the IRA or qualified plan itself. If an annuity is purchased to fund an IRA or qualified employer-sponsored retirement plan, it should be done for the annuity features and benefits other than tax deferral.

U.S. Treasury Circular 230 may require us to advise you that "any tax information provided in this document is not intended or written to be used, and cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer. The tax information was written to support the promotion or marketing of the transaction(s) or matter(s) addressed and you should seek advice based on your particular circumstances from an independent tax advisor."

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THE RETIREMENT SAVINGS DRAIN

THE HIDDEN & EXCESSIVE COSTS OF 401(K)S

BY ROBERT HILTONSMITH

ABOUT DĒMOS

Dēmos is a non-partisan public policy research and advocacy organization founded in 2000. Headquartered in New York City, Dēmos works with policymakers around the country in pursuit of four overarching goals—a more equitable economy with widely shared prosperity and opportunity; a vibrant and inclusive democracy with high levels of voting and civic engagement; an empowered public sector that works for the common good; and responsible U.S. engagement in an interdependent world.

ABOUT THE AUTHOR

Robert is a Policy Analyst in the Economic Opportunity Program at Dēmos. He joined Dēmos in March 2010 to provide research and analysis on issues surrounding retirement security in the United States, with a particular focus on how these issues affect young people. Since then, he's written on a wide variety of topics, including tax policy, fiscal policy, health care, and the labor market. Robert's research has been widely covered in the press, including the *Washington Post*, *Newsweek*, *Marketwatch*, *Reuters*, and *Kiplinger*. His writing has appeared in a variety of news outlets including *POLITICO*, *Newsday*, and *The American Prospect*.

He has a M.S. in Economics from the New School for Social Research and a B.S. in mathematics and philosophy from Guilford College.

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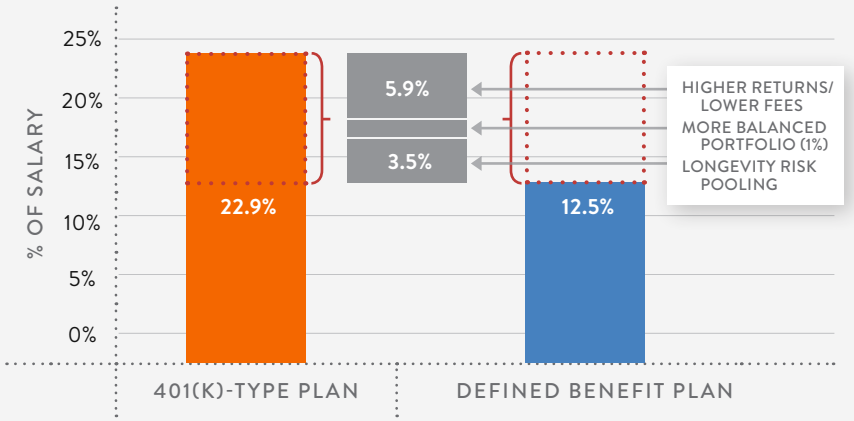
INTRODUCTION

Do you know how much you pay for your retirement plan? If you're like many Americans saving for retirement in a 401(k)[i], the answer is "no." An AARP survey[1] found that 65 percent of 401(k) account-holders had no idea they were even paying fees, and 83 percent, or 5 out of every 6, lacked even basic knowledge about the many fees and expenses that everyone with a 401(k) pays. These include fees to cover the costs of advertising the plans and the companies who run them, fees to pay various investment managers of the funds in the plan, even fees to cover the costs of buying and selling the underlying stocks and bonds in which retirement accounts are invested. These fees, however, are taken "off the top" of investment returns or share prices—in other words, the rates of return and share prices reported to you in account statements and plan documents are post-fee. Because of this, retirement and bank account statements contain no evidence of these fees, and thus accountholders generally have no inkling how much all of this costs them.

Excessive 401(k) fees can take a surprisingly large bite out of the retirement savings of American families who are already struggling to save amidst long-stagnant wages and an idling economy. Dēmos has calculated that an "ordinary" American household (details provided later in this brief) will pay, on average, nearly $155,000 over the course of their lifetime in effective total fees. To put this in perspective, this household could have bought a house with the amount they paid in fees. This is a price that families already trying to weather the risks of the contemporary U.S. economy can scarce afford to pay. The country needs to implement one of the many more efficient retirement savings ideas that have been proposed by institutions and individuals across the political spectrum to give all Americans a reasonably-priced means to save for retirement.

Fig. 1 | COST TO PROVIDE AN ADEQUATE LEVEL OF RETIREMENT INCOME AS A % OF EMPLOYEE SALARY



SOURCE: Almeida, Beth, and William Fornia. *A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans*. National Institute on Retirement Security, August 2008.

Though some might counter that fees are simply the price we pay for expert investment management[2], there is ample evidence that these fees are excessive—i.e. more than necessary to deliver excellent returns to savers—and can cost savers tens or even hundreds of thousands of dollars over the course of their lifetimes. As Figure 1 illustrates, the National Institute on Retirement Security estimates that administering the average defined benefit plan, or traditional pension, costs 46 percent less than a typical 401(k) to provide the same benefit level in retirement, largely because of the higher fees and lower investment

[i] In this brief, "401(k)" is used as shorthand to refer collectively to all types of individual retirement savings accounts, including 401(k)s, 403(b)s, 457s, IRAs, Keoghs, SEPs, etc.

returns of 401(k)s and the ability of defined benefit plans to pool risk.[3]

This brief will show that the excessive fees of the 401(k) system are due to the inefficiencies of an individualized retirement system. These fees, which are almost exclusively paid by savers, are an inherent part of that system, this brief argues, thus that any reforms to 401(k)s short of a complete overhaul can't eliminate, but only marginally reduce, excessive fees. Such reforms include oft-suggested fixes such as increased investment in index funds[4] or regulatory tweaks, like the new Department of Labor fee disclosure rules slated to take effect on July 1st. These rules require most, but not all, fees charged by a mutual fund to be disclosed transparently to investors in a similar format to the interest rate-disclosure rules imposed on credit cards by the CARD Act. The new rules are a welcome step in the right direction, and will likely help reduce fees as sophisticated employees realize for the first time how much their retirement plan is costing them. However, as this brief will show, simply disclosing fees more transparently cannot correct the other factors that keep fees high nor can it fix the other weaknesses of an individualized retirement system[5]—market risk and longevity risk, among others. The multitude of risks and excessive fees are in reality consequences of the 401(k)'s individualized, inefficient structure, and are an inherent part of that structure. If we want a retirement system that reduces savers' exposure to risk and charges them reasonable fees, the 401(k) cannot be the basis of such a system; simply, it needs to be replaced. What the new fee disclosure rules will do, however, is expose to 401(k) savers for the first time just how bad of a deal 401(k)s are, and build popular support for the wholesale reform of the retirement system that is needed to ensure that Americans have a chance to enjoy a comfortable retirement.

The brief simplifies the complex world of 401(k) fees by exposing four major fee categories: administrative, marketing, asset management, and trading. It details the costs of these fees, nearly all of which are borne by employees, and explains why these fees are so high. It ends with our calculations of the real costs of fees to several types of savers, and argues that the inherent inefficiencies of the 401(k) system necessitate a complete overhaul, rather than a tweak, of that system.

WHY ALL THIS TRADING?

Every mutual fund incurs trading costs each time it buys or sells the underlying stocks and bonds in which the fund is invested. Mutual funds buy or sell assets for two reasons: to fulfill the fund's investment objectives and whenever an investor buys or sells shares of the fund.

In the first case, actively-traded funds, which seek to maximize returns by rapidly buying and selling assets, incur much higher trading costs than passive funds, such as index funds, which simply invest in a set diversified portfolio or in a fixed mix of assets.

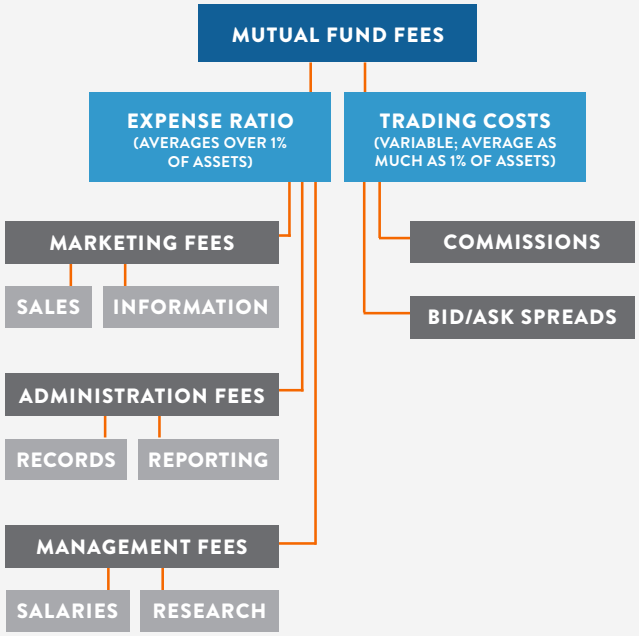
In the second case, each time an investor buys shares of the mutual fund, it must then purchase additional assets, incurring a trading cost. And each time an investor sells shares, the fund must pay the investor either out of its cash reserves or by selling some of its assets, also incurring trading costs. Thus, trading costs rise the more active the mutual fund's investment strategy; and the more investors trade the shares of the mutual funds itself.

TYPES OF 401(K) FEES

When an employee invests in a 401(k), they must choose from a set menu of investment options chosen by their employer. These options are primarily mutual funds, but can also often include company stock. A plan's mutual funds, in turn, must generally include a range of investment strategies, focusing on stocks (domestic and international), bonds (corporate or government), money market investments, or a mixture of assets. Each mutual fund in a 401(k) has a range of operating costs; costs which savers, who are the sole source of the funds' assets and investment firms' profits, pay in the form of fees. These fees, however, are mostly hidden from savers, because they're taken off the top of both mutual fund returns and share prices. Fees, therefore, don't appear on 401(k) account statements; they're generally disclosed only in the fund prospectuses or additional documentation for each fund in a 401(k)—documents which many savers don't read or couldn't reasonably understand. These fees/costs broadly fall into 4 categories (summarized below and in Figure 2):[6]

- **ADMINISTRATIVE FEES:**
  Fund expenses for keeping records, providing statements, processing transactions, ensuring the plan complies with applicable regulations, answering savers' questions, and providing customer service. Administrative fees generally range from 0.2 percent to 0.4 percent annually.[7]
- **ASSET MANAGEMENT FEES:**
  Salaries for portfolio managers (who oversee different portions of a fund's assets), investment researchers, and the other employees responsible for fund's investments. Asset management fees generally range from 0.5 percent to 1 percent annually.[8]
- **MARKETING FEES:**
  Also called 12b-1 fees, these include the expense of informing savers and potential savers about the mutual fund, including advertisements, brochures, and other informational material. Increasingly, mutual funds are lumping together a number of other costs under the umbrella of 12b-1 fees, including rebates to 401(k) "recordkeepers"—the companies that bundle various mutual funds into a 401(k) plan, sell it to employers, and then keep the records for the savers in the 401(k)s. Marketing fees are limited to a maximum of 1 percent annually.[9]
- **TRADING FEES:**
  The costs incurred by the fund when buying and selling the securities (bonds, stocks, etc.) that comprise a mutual fund's underlying assets. The reasons why mutual funds trade their assets are several, and summarized in the box below. Each mutual fund pays a commission to a securities broker each time it buys or sells a security, and it loses small amounts of money on "bid/ask spreads" that represent the difference between the actual buy or sell price for a security and its market value. In other words, if the fund wishes to sell a security, it generally must do so at a price that is slightly lower than its market value, and vice versa. If a mutual fund sells large blocks of a security, it must often do so at a progressively lower price, increasing costs. These fees vary from year to year depending on both the number of shares of a mutual fund bought and sold in a year, and on the frequency with which fund managers buy and sell the securities that comprise the underlying assets of the fund.

Fig. 2 | THE COMPONENTS OF MUTUAL FUND FEES



SOURCE: Adapted from Kopcke, et al. "The Structure of 401(k) Fees." *Issue in Brief* (2009): 9–3

Administrative, management, and marketing fees—a mutual fund's (relatively) constant costs— are summarized in a fund's expense ratio, as depicted in Figure 2. The expense ratio is the ratio of these fixed costs, calculated annually, divided by the total assets of the mutual fund. However, the expense ratio, which is intended to summarize the fund's total cost to investors, does not include any of the fund's variable costs, the most significant of which are trading fees. Because they're not included in the expense ratio, trading fees are nearly completely hidden from retirement savers, though they can be nearly as large as the expense ratio itself. According to the Investment Company Institute, the trade association of the investment industry, the median expense ratio of funds in 401(k) plans was 1.27 percent in 2010. However, because most retirement savers are in larger plans, the median expense ratio paid by savers was 0.78 percent.[10] The expense ratio for the funds in a 401(k) can be found in the summary documents for the 401(k) plan that savers are given when they begin a job or enroll in the plan; they can also be found in the prospectuses for the individual mutual funds themselves. Because mutual funds' expense ratios are fixed, and cannot be raised without the consent of the shareholders of the fund, the ratios are reported in 401(k) plan summaries in a table that often resembles Figure 3.

Fig. 3 | **DEMOS EMPLOYEE 401(K):** *MENU OF MUTUAL FUNDS, YIELDS, AND EXPENSE RATIOS*

INVESTMENT FUND	FUND INCEPTION DATE	10-YEAR YIELD	YIELD, INCEPTION TO DATE	EXPENSE RATIO
SSgA Government Money Market Fund	03/01/1983	1.52	3.79	0.75
JPMorgan Government Bond Fund - Class A	03/05/1993	5.89	5.88	0.76
PIMCO Investment Grade Corporate Bond Fund – Class A	07/30/2004	N/A	7.23	0.90
DWS Unconstrained Income Fund – Class A	06/23/1977	7.69	8.58	1.08
Fidelity Advisor Freedom Income Fund – Class T	07/24/2003	N/A	3.56	0.99
Fidelity Advisor Freedom 2010 Fund – Class T	07/24/2003	N/A	4.25	1.14
Fidelity Advisor Freedom 2020 Fund – Class T	07/24/2003	N/A	4.64	1.20
Fidelity Advisor Freedom 2030 Fund – Class T	07/24/2003	N/A	4.38	1.26
Fidelity Advisor Freedom 2040 Fund – Class T	07/24/2003	N/A	4.36	1.30
Fidelity Advisor Freedom 2050 Fund – Class T	06/01/2006	N/A	0.01	1.32
BlackRock Global Allocation Fund, Inc. – Investor A Class	10/21/1994	8.12	9.54	1.17
Janus Balanced Fund – Class S	07/06/2009	N/A	9.78	1.09
Davis New York Venture Fund – Class A	02/17/1969	3.37	11.47	0.89
SSgA S&P 500 Index Fund	01/01/1978	2.26	10.39	0.70
Thornburg Value Fund – Class R4	02/01/2007	N/A	-4.03	1.25
Calvert Equity Portfolio – Class A	08/24/1987	3.28	7.04	1.23
Goldman Sachs Capital Growth Fund – Class A	04/20/1990	1.26	8.16	1.14
SSgA S&P MidCap Index Fund	09/01/1988	6.31	11.22	0.70
SSgA Russell Small Cap Index Fund	10/01/1996	4.85	7.72	0.95
Alger Small Cap Growth Institutional Fund – Class I	11/08/1993	6.08	8.49	1.23
Thornburg International Value Fund – Class R4	02/01/2007	N/A	-1.00	1.25
Invesco Developing Markets Fund – Class A	01/11/1994	15.43	5.81	1.53

SOURCE: Dēmos 401(k) Plan Summary Documents

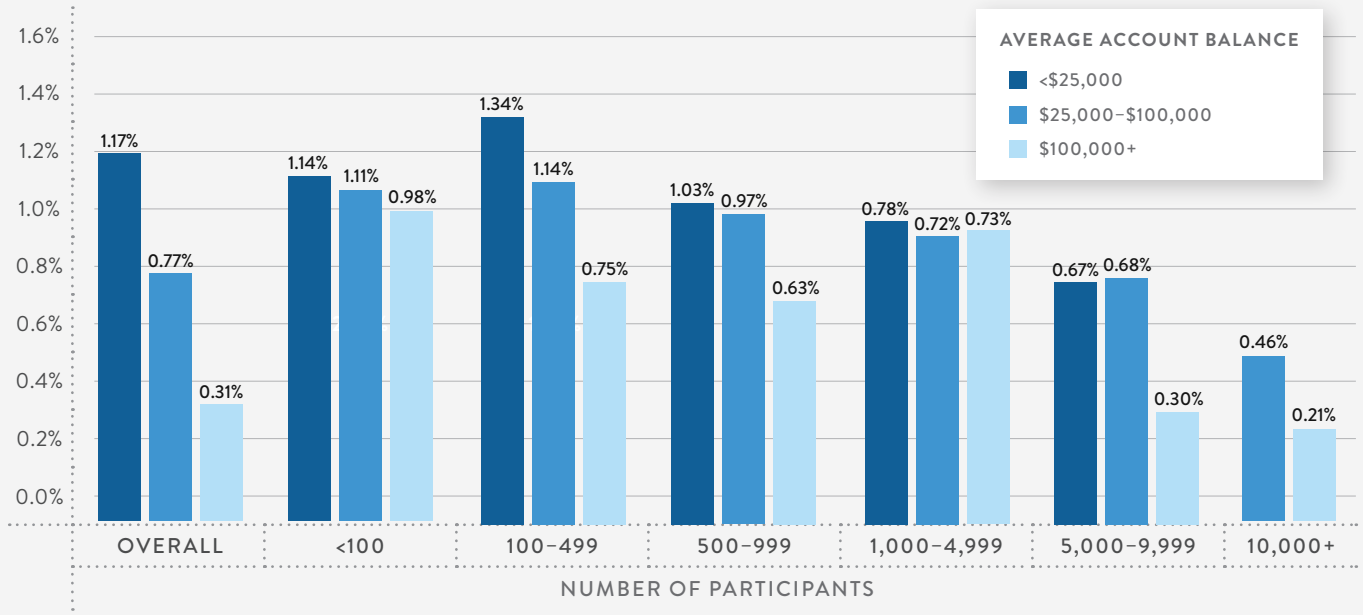
THE TRUTH ABOUT FEES

Examining the menu of mutual funds available in a real-world 401(k) helps to illuminate the true impact of fees. Figure 3, from Dēmos' own 401(k), lists, in columns running from left to right, our organization's available investment funds (mostly mutual funds), the date the mutual fund was created, the average yearly yield (return) for each fund over the past 10 years, the average yield overall since the fund was created, and the fund's expense ratio, all expressed as percentages. The expense ratios, in the last column, range from 0.7 percent to 1.32 percent and are fairly typical for a smaller 401(k). However, the average expense ratio of these funds, 1.1 percent, is slightly lower than the median of 1.27 cited above. According to the Investment Company Institute, asset-weighted[ii] expense ratios average 0.7 percent for bond mutual funds (funds that are mostly or wholly invested in bonds) and 1 percent for equity mutual funds;[11] the funds in Dēmos' 401(k) are a mix of the two kinds. These fees are taken "off the top" of the funds' yields, meaning that fees have already been deducted from the yields listed in the table. In other words, a Dēmos employee who had invested in these funds over the past years would have actually earned the yields listed.

Figure 4 helps to put Dēmos' 401(k) plan into context in the universe of 401(k) plans. Though Dēmos, with 70 employees, is not a small employer by the standards of the Bureau of Labor Statistics, its 401(k) plan is a small plan, according to data from a recent study by the Investment Company Institute and Deloitte.[12] Though about three-quarters of all 401(k) plans are smaller than Dēmos' in terms of assets and participants, because most savers are part of large plans, nearly 90% of all savers belong to a plan larger than Dēmos'. And as Figure 4 shows, size matters. The average expense ratio of the mutual funds in a 401(k) plan decreases precipitously as both the plan's assets and its number of participants rise. The smallest plans, with 10 participants and an average account balance of $10,000 have an average expense ratio of over 1.4 percent, while the expense ratios of the largest plans average less than a third of that, less than 0.4 percent. This difference, as the following example shows, can have a profound effect on the size of savers' nest eggs when they retire.

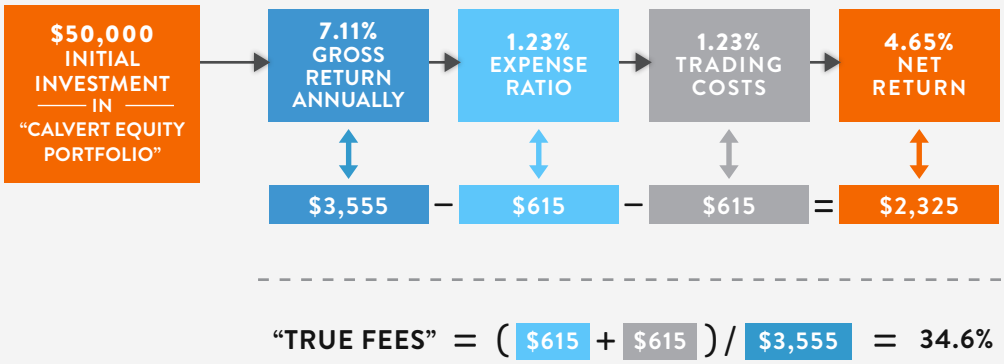
[ii] An asset-weighted average is the industry-wide average expense ratio, calculated by weighting the expense ratio of each fund by the value of assets that are invested in that fund. The asset-weighted expense ratio is lower than the "vanilla" average or median because a large share of total 401(k) assets are invested in large 401(k) plans, whose funds generally have lower expense ratios.

Fig. 4 | **MEDIAN MUTUAL FUND EXPENSE RATIO:**
BY AVERAGE ACCOUNT BALANCE & NUMBER OF PLAN PARTICIPANTS



SOURCE: Rosshirt, Daniel. Inside the Structure of Defined Contribution/401(k) Plan Fees. Deloitte/ICI, November 2011.

Fig. 5 | **MUTUAL FUNDS' TRUE COSTS:** *"CALVERT EQUITY PORTFOLIO" EXAMPLE*



SOURCE: Demos Analysis.

An example investment with actual dollar values helps to clarify the impact of the expense ratio on retirement savers' account balances. Let's pretend that I have $50,000—the median amount that households with retirement savings have in their retirement account(s)[13]— invested in the "Calvert Equity Portfolio" fund, located about ¾ of the way down in Figure 3's list of funds. The Calvert fund has averaged a 4.65 percent net return, or yield, over the past decade, and for simplicity's sake, let's pretend it also yields 4.65 percent, net, in the coming year. So, at the end of the year, my $50,000 investment will have grown to $52,325. This seems simple enough, but in reality, this $52,325 is actually my balance **after** the Calvert fund has deducted, behind the scenes, its explicit fees—i.e. its expense ratio—of 1.23 percent. As mentioned above, this is 1.23 percent of my entire account balance, so Calvert actually deducted its $615 in fees before it gave me my return. In reality, Calvert actually invested my $50,000 and earned ($2,325+$615=) $2,930, in gross investment returns, which works out to be 5.88% of my original $50,000. It then took its fixed 1.23%, $615 in my case, and gave me the remainder, which happens to work out to the 4.65 percent return listed.

However, reporting fees as a percentage of assets actually disguises their true cost. In much of the rest of the business world, transaction fees are generally expressed as a percentage of the value added by a purchased service, or by the value of a purchased good, not as a percentage of our own assets. If you purchase a ticket to an event online and the company selling you the ticket charges you a service or convenience fee of, say, 5 percent, they mean 5 percent of the value of the good they're selling you—the price of an event ticket—not as a percentage of your bank account balance. But that's exactly what mutual funds are doing: they list fees as a percentage of your account balance. But investors aren't paying mutual funds to store their money; they're paying them to earn returns on their investment. A more accurate way, therefore, to express mutual fund fees would be as a percentage of gross returns they earn investing savers' money, not as a percentage of assets themselves. Using our above example, Calvert deducted $615 in fees from the $2,930 they earned investing my money. If we express fees as a percentage of gross return then Calvert actually charged me 615/2930=20.9 percent in fees. Calculating fees in this more accurate fashion reveals that fees are actually far larger and, as we'll show in our real world example below, more harmful to workers' retirement prospects than the seemingly-small expense ratios imply.

The 20.9 percent "true fee" calculation above, however, doesn't include trading fees, which are not accounted for in the fund's fixed expense ratio, which is often purported to measure a fund's cost to investors. Despite this exclusion, savers also bear the costs of trading fees. Savers (and sometimes employers, depending on what share, if any, of the costs of a 401(k) they choose to pay) by definition pay these fees for mutual funds: since savers provide the only source of capital for investment funds, all trading fees incurred by the fund must necessarily come out of that savings or the income earned on that savings.

So why then are trading fees, which often cost savers as much as or more than the explicit expense ratio,[14] only disclosed in cryptic "Statements of Additional Information," which even then only report aggregate, not per-participant, trading costs? The answer given by most mutual funds is that trading costs vary, sometimes substantially from period to period. This is certainly true: the frequency of both types of trades that incur trading fees—when the mutual fund trades its underlying assets and when the shares of the mutual fund itself are traded—varies substantially with market conditions. The more important reason, perhaps, for funds' lack of transparency around trading fees is that mutual funds are not legally required to disclose trading costs except in the aforementioned arcane "Statements," and so, these statements are only place they do disclose them. Mutual funds have an incentive not to disclose trading costs any more transparently because, according to basic economic theory, hiding the true costs paid by 401(k) savers will dissuade fewer potential investors and therefore increase profits.

Including trading fees in our above example fee calculation reveals that 401(k)s' true costs to savers are even larger. Using the Calvert Equity Portfolio fund (an actively-managed mutual fund) again as an example, if its explicit expense-ratio fees, are 1.23 percent, then we can estimate, given previous research, that its trading fees are likely equally costly, meaning that its total, true fee burden is double the expense ratio: 2.46 percent. So, updating our previous calculation, the fund has actually earned an average gross return in the past decade of 7.11 percent, and according to our "true fee" calculation, takes a surprising 34.6 percent of that rate of return to cover its expenses, as shown in Figure 5. But even this 34.6 percent number understates the Calvert fund's fees. The 7.11 percent gross return is what economists call the fund's "nominal" return, i.e. before the effects of inflation are taken into account. Since inflation generally averages about 2 percent per year, the Calvert fund actually earned a real, inflation-adjusted return of 5.01 percent in the past decade. Thus, after adjusting for inflation, the fund's true fees are 2.46/5.01, or an astronomical 49.1 percent!

WHY ARE FEES SO HIGH?

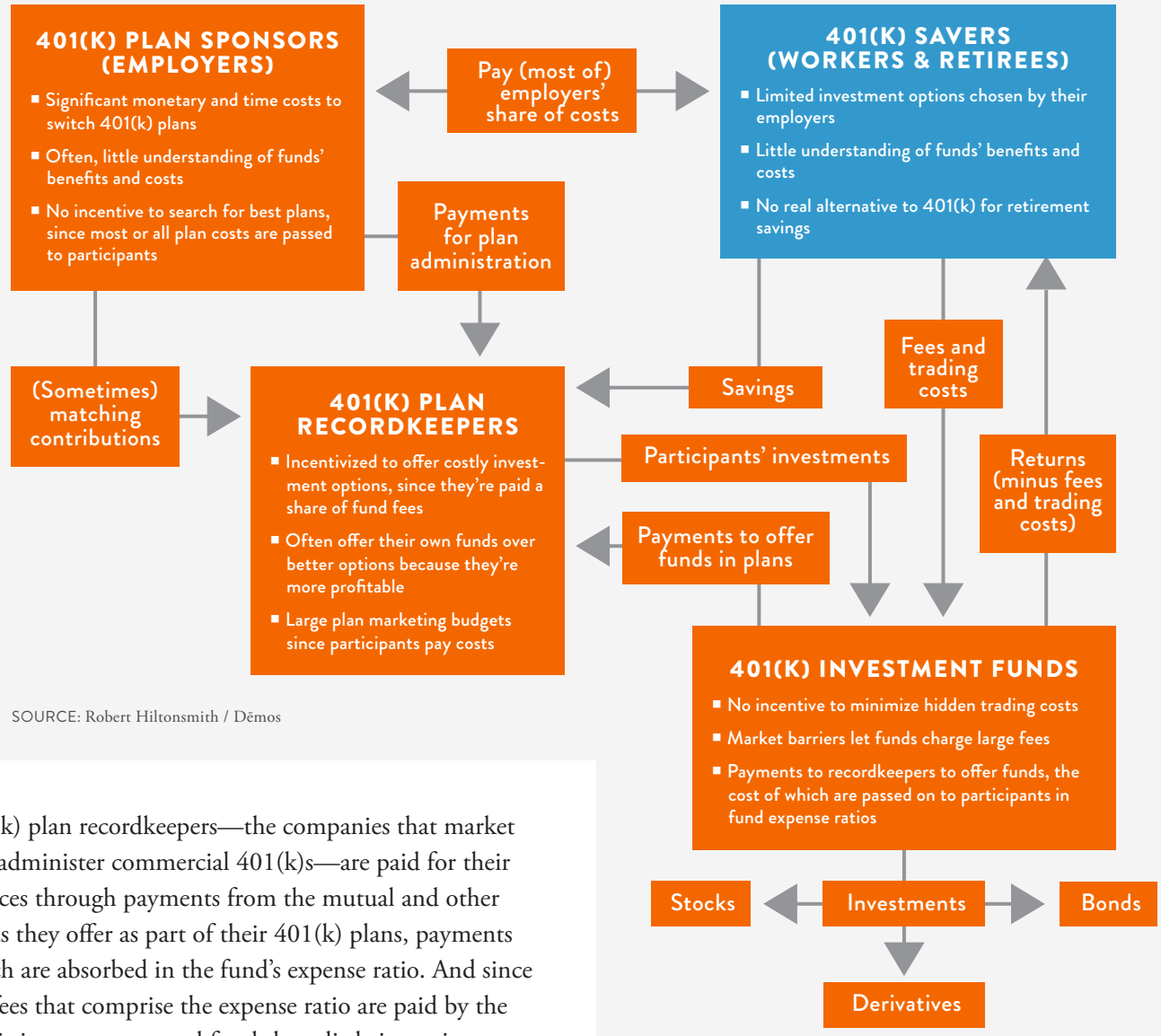
More than 30 years after the great shift in our country's retirement system from defined benefit pensions to 401(k)s and similar plans, why are fees, which limit Americans' already-scarce retirement savings, still so high? The answer is that the market for individual-account retirement savings is neither efficient nor competitive. 401(k) savers and plan-sponsoring employers lack information about the true costs or even existence of retirement plan fees and how they reduce returns. Both employers and employees also face difficult barriers to switching between investments or plans. Both these barriers and the lack of fee information combine to make the market for 401(k)s inherently uncompetitive. And this lack of competition in turn allows the sellers in the retirement market—the investment funds and 401(k) providers—to charge the buyers—employers and workers—whatever price for their services that maximizes the sellers' profits. This price is further inflated by the inefficiencies of the individualized, atomized mutual fund industry. Because 401(k) savers' assets are spread between thousands of essentially-identical or similar mutual funds, many savers, particularly those in smaller 401k plans, are unable to benefit from efficiencies—lower costs—from what economists call "economies of scale."

To detail why these inefficiencies are an inherent part of the 401(k) market, we first need to clearly name and understand all of the "players" in this market since its complexity is a major reason why providers are able to charge such high fees. Figure 6 depicts the four different players in the market and the capital flows between them, and outlines some of the advantages and disadvantages each player faces.

Complexity

The first reason that fees are high is the inherent complexity of the system. As Figure 6 shows, the many players between 401(k) savers and the underlying assets—stocks, bonds, derivatives, etc.—in which savers' funds are actually invested both increase the complexity of the 401(k) system and create additional costs, the vast majority of which are borne by invested workers and retirees.

Fig. 6 | THE PLAYERS & FLOWS IN THE 401(K) MARKET



SOURCE: Robert Hiltonsmith / Dēmos

401(k) plan recordkeepers—the companies that market and administer commercial 401(k)s—are paid for their services through payments from the mutual and other funds they offer as part of their 401(k) plans, payments which are absorbed in the fund's expense ratio. And since the fees that comprise the expense ratio are paid by the unwitting savers, mutual funds have little incentive to keep those payments to recordkeepers low, and so they engage in bidding wars to be included in the most lucrative plans. Along with payments to middlemen in the 401(k) system—such as the stockbrokers and exchanges paid commissions to execute purchases and sales of assets for the funds, as well as the high salaries and expenses of the mutual funds themselves—the expenses incurred by all layers of this complex system are passed directly on to investors. Combined with the complacency of employers and the high barriers to finding the best retirement plan, the 401(k) system is a very bad deal for workers.

Employees' Lack of Knowledge

As the previously-mentioned AARP study shows, most workers who contribute to 401(k)s have extremely little knowledge of the costs of their retirement plan. This ignorance, however, is hardly unjustified: deciphering the complexities of the opaque, confusing 401(k) system is practically a full-time job, one which most people simply do not have time for on top of the already-overwhelming responsibilities of work, family, and life; in fact,

deciphering complex financial markets is precisely what professional financial advisors do. 401(k) savers perhaps assume that, given the limited menu of funds offered in their employer plan, their employer has done their homework for them, and all of the available investment options are safe and relatively interchangeable. In practice, savers frequently choose unwisely: a majority of 401(k) investors believe that higher fees guarantee higher returns,[15] when in fact the opposite is true—lower-fee index funds often have higher net returns than higher-fee actively managed ones.[16] This lack of knowledge of the costs of their retirement plan hurts them in other ways, as well: it allows the other players in the 401(k) system—employers, recordkeepers, and the funds themselves—to pass the costs of the system on to workers, leaving them holding a large bill.

Employers' Lack of Knowledge

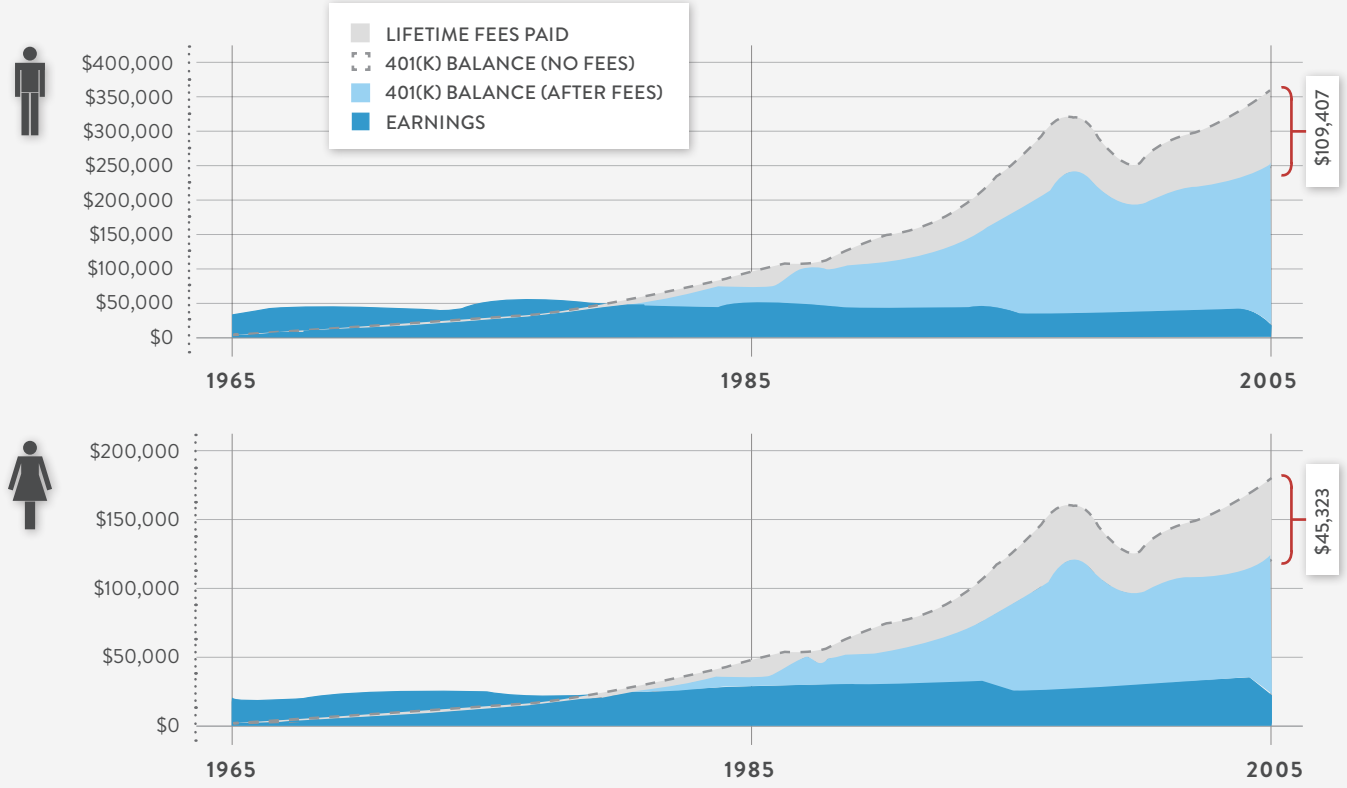
Employers offer 401(k)s to their workers because they believe that offering a retirement plan helps them attract and retain skilled employees. However, because employers have little incentive to ensure that they offer their workers the best possible retirement plan, they look to minimize the cost to themselves of offering those benefits, which they do in several ways. When shopping for a retirement plan, recordkeepers typically offer employers several versions of the same plan, versions that have identical investment options but higher or lower expense ratios for those options depending on how much or little employers want to pay, yearly, to the recordkeeper for plan administration. Employers are increasingly choosing plans with little or no employer costs but higher expense ratios, passing on the costs to their employees. A 2011 survey by the Investment Company Institute reported that employees currently pay 91 percent of all fees, a steep rise from the 78 percent they paid just two years earlier.[17]

Fees are also driven up because switching retirement plans can be quite expensive to employers, in terms of lost employee time. Therefore, the less that employers directly pay for their retirement plan, the less incentivized they are to look for a lower-cost one, leaving their employees stuck with a costly plan. Other employers might not even consider switching retirement plans, not realizing how costly their plan is to their employees. At many companies or organizations, particularly small ones, there is a single employee in charge of administering the retirement plan, and plan administration is often just a small portion of their job responsibilities.[18] Decoding the complexities of a retirement plan's fee structure may be impossible given their limited time and knowledge.

Inefficient Market Structure

The final reason why mutual fund fees are excessive is simply the structure of the individualized retirement market itself. In this market, the $9.2 trillion that savers had invested in IRAs and 401(k)-type plans, as of 2010, is divided between thousands of "different" mutual funds in dozens of investment classes, which in reality (by class) differ little from one another: the long-term standard deviation of funds from class-average performance is actually quite low. This dispersion of 401(k) assets actually hurts savers much more than it benefits them. The division of assets amongst so many funds prevents 401(k) savers from benefitting from the lower costs and pooling of risk resulting from "economies of scale." Large asset pools, such as state and local pension funds, can also use the leverage that comes from size to negotiate lower asset management fees, and administrative costs per investor are naturally lower since those costs are divided amongst a greater number of people. In addition to reducing costs, asset pooling benefits investors in other ways as well. When investors pool their assets and returns are shared evenly, market risk to these investors is reduced, since the asset managers can invest in a more diversified portfolio with a longer-term horizon. Asset managers of large investment pools also have access to certain asset classes, such as private equity and hedge funds, in which small investors are barred from investing.

Fig. 7 | **MODEL ESTIMATES OF LIFETIME 401(K) BALANCE & FEES**



SOURCE: Dēmos' Fee Model Estimates (See Appendix for Methodology).

MODELING THE LIFETIME COST OF FEES TO "IDEAL SAVERS"

How much, exactly, do all these fees from the complex, opaque 401(k) system end up costing workers over the course of a lifetime of saving for retirement? After all, there would hardly be cause for concern if fees added up to only a few dollars, or even a few hundred, minimally impacting workers' retirement prospects. But the reality is that, even for middle-income households, under ideal savings scenarios, the lifetime costs of 401(k) fees can be hundreds of thousands of dollars.

To calculate how much these fees cost over a lifetime, we used a hypothetical two-earner household, each of whom earned the median income every year from age 25 to their retirement at 65, beginning in 1965 with steady contributions through 2005. We selected this time frame to estimate the effects of a lifetime of savings and fees, with an end—where their lifetime returns weren't inflated or deflated by an expansion or recession (see Appendix for details on our methodology). Based on actual average contribution rates[20], we assume that this household begins their career saving 5 percent of their combined gross income in a 401(k), and steadily increases 8 percent by retirement. Though both members of our household earn the median income, they are actually "ideal" retirement savers because they both save consistently over their entire careers without interruption or withdrawing any portion of their savings early. In the real world, many families experience significant drops in their income over the course of a lifetime as they suffer through unemployment and economic downturns, or cut back on their hours to take care of their children or parents. They also often cut back

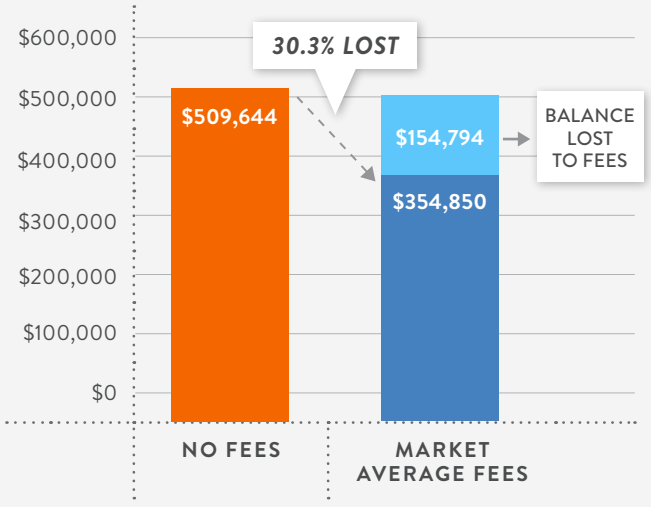
or stop saving for retirement at some point during their working lives, or withdraw from their retirement savings.

We do not take into account any employer contributions; our fee calculation is simply intended to reflect the returns lost from savers' own savings. We presume that they invest their savings equally in a mutual fund which invests primarily in bonds and a fund which focuses on stocks. The household's stock and bond mutual funds each annually earn the average, index return for their asset class, and the returns on the household's savings are compounded annually. As per the Investment Company Institute's most recent data on fees[21], we assume these funds carry the (asset-weighted) mean expense ratio for their asset class: 0.72 percent for bond mutual funds and 0.95 percent for stock mutual funds. Finally, we presume, according to the consensus among retirement experts, including the CRR[22] and Brightscope[23], that funds all have trading fees that equal the explicit expense ratio. For more detail on the methodology behind our calculation, see the appendix.

Taking all this into consideration, how much would this "ideal" household have paid in retirement account fees over its lifetime? Figure 7 depicts the results of the model, showing the progression of each household member's earnings, hypothetical 401(k) balance, and fees over their working lifetimes. Figure 8 summarizes the household's aggregate 401(k) balance at retirement, and shows fees' lifetime costs: as much as **$154,794**. To put that in perspective, that's the average cost of a house in many parts of the country, or more than the cost of a public-university education, including room and board, for two children. So, for this ordinary household, paying mutual fund fees cost them that home they could have bought with their retirement nest egg. And even worse, for most households, these fees don't stop at retirement; in fact, if a household leaves most of its assets in its 401(k) (as many do), these fees can be quite substantial. To give an idea of the magnitude of these post-retirement fees, let's assume that our "ideal" household, who, as shown in Figure 7, retires with a combined 401(k) balance of $357,872, keeps its entire nest egg in its 401(k) upon retiring. In the first year of their retirement, they would effectively pay, in expense-ratio fees and trading costs, $5,723 in total fees in that first year of retirement alone.

As another example of how much fees can cost a household over its working lifetime, consider a higher-income household, one who earns more income than three-quarters of American households, and who saves and invests identically to the "ideal" household above, can expect to pay an even steeper price: (as much as) **$277,969**, according to Dēmos ' calculations. Considering that a significant portion of these fees goes to paying the high salaries and expenses of the investment professionals managing these funds, asking struggling American households to pay these prices to save for retirement is more than patently unfair, it's immoral.

Fig. 8 | **FEES' COSTS TO AN "IDEAL" HOUSEHOLD:**
401(K) BALANCE AT RETIREMENT



SOURCE: Dēmos' Fee Model Estimates

TOWARD A MORE IDEAL SYSTEM

Between the complexity and many layers of today's retirement market, the barriers that employers, particularly small ones, face in choosing the best retirement plan or switching to a better one, and the lack of control that employees have over their investments, it's clear that the high costs of the country's individual, 401(k)-style retirement system cannot be solved by regulatory tweaks or even the increased transparency that the Department of Labor's new rules will engender. These structurally-high fees, combined with the multitude of risks—such as losing one's savings to a market downturn, outliving ones saving, and several others—faced by 401(k) investors make 401(k)-style plans entirely unsuitable to be the primary income supplement to Social Security in retirement, as they are for most workers today.

What's the solution, then, if 401(k)s can't be fixed? Simply, this country needs a new private retirement system. All workers need a safe, low-cost secure account to save for retirement, one that can also provide a lifetime stream of income when they retire; in other words, an account that protects workers from the severe risks and high costs of 401(k)-type plans. Individual Retirement Accounts (IRAs), the vehicle for administration's "Auto IRA" plan included in the proposed FY2013 budget, don't meet these criteria. IRAs expose savers to the same set of risks as 401(k)s, and according to the Government Accountability Office, have even higher fees than their employer-based counterparts.[24]

So, if not the Auto-IRA, then what kind of accounts should be created? Retirement USA, a coalition of organizations concerned about the inadequacies of the country's private retirement system, has proposed 12 principles, detailed on page 14, that a good retirement savings vehicle should meet—including ensuring such a vehicle is low-cost by requiring that assets be pooled—and highlights several plans that meet those principles. The highlighted plans—including Dēmos Distinguished Senior Fellow Dr. Teresa Ghilarducci's "Guaranteed Retirement Account" (GRA) proposal[25]—would not only mitigate many of 401(k)s' risks but cost savers far less than the average 401(k) as well. GRAs, in particular, would have total fees near the level of the average defined benefit pension plan, since the plan shares many of the advantages of DBs, including pooling, that drive down their fees, as well.

Whether through the creation of GRAs or another similarly-featured proposal, one thing is clear: the country's retirement system is in desperate need, now, of reform, so that workers saving for retirement today can be spared from paying the high fees of an inherently broken system.

RETIREMENT USA'S TWELVE PRINCIPLES FOR RETIREMENT

CORE PRINCIPLES

Universal coverage. Every worker should be covered by a retirement plan in addition to Social Security.

Secure retirement. Workers should be able to count on a steady lifetime stream of retirement income to supplement Social Security.

Adequate income. Everyone should be able to have an adequate retirement income after a lifetime of work.

SUPPORTING PRINCIPLES

Shared responsibility. Retirement should be the shared responsibility of employers, employees and the government.

Required contributions. Employers and employees should be required to contribute a specified percentage of pay, and the government should subsidize the contributions of lower income workers.

Pooled assets. Contributions to the system should be pooled and professionally managed to minimize costs and risks.

Payouts only at retirement. No pre-retirement withdrawals or loans should be permitted, except for permanent disability.

Lifetime payouts. Benefits should be paid out over the lifetime of retirees and their partners.

Portable benefits. Benefits should be fully and easily portable between jobs.

Voluntary savings. Additional tax-favored voluntary contributions should be permitted, with reasonable limits.

Efficient and transparent administration. The system should be administered by efficient and transparent government agency or non-profit institution with a board representative of all stakeholders.

Effective oversight. Oversight of the new system should be by a single government regulator dedicated solely to promoting retirement security.

SOURCE: Retirement USA Website, www.retirment-usa.org/ourprinciples

APPENDIX: DETAILED METHODOLOGY FOR FEE MODEL

Our calculation uses the example of a household with two income earners, a man and a woman, each of whom earns the median income for their age and gender each year of their working lifetimes, which we define as the 40 years between ages 25 and 65. We decided to use a historical working lifetime, settling on the years between 1965 and 2005, as opposed to projecting a future working lifetime. By using past historical returns and income data, we avoid the imprecise science of estimating future earnings and market returns decades into the future. We constructed our model as if 401(k)s had been available since the beginning of our household's working lifetimes in 1965, though in reality 401(k)s have only been available since the early 1980s, and only common since the mid-1990s.

In our model, each earner saves a set portion of their individual salary in a separate but identical 401(k) account. Their yearly savings rates are set at the actual average rates for 401(k) savers broken down by age, gender, and income, as detailed in Copeland (2009); as a result, both individually begin their careers at age 25 saving 5.3% of their salary in their 401(k), and gradually increase to their savings rate to 9.2% by age 65. Both earners save every year of their working lifetimes without interruption, and never withdraw or borrow from their 401(k).

Both earners invest their savings in an identical 401(k) with only two investment options: a stock index fund and a bond index fund. For simplicity of calculation, we assume that both earners invest exactly half of their savings in each option each year, with no portfolio rebalancing. To produce a conservative estimate of the lifetime fee cost, we presume that each fund has a constant expense ratio equal to the asset-weighted average expense ratio for its asset class; thus, according to Reid (2011), we set the bond index fund's expense ratio at 0.72 percent and the stock index fund's expense ratio at 0.95 percent. This is a conservative estimate because mutual fund expense ratios have declined by about 50% since 401(k)s were introduced, according again to Reid (2011). We also assume, according to the research consensus cited above, that the stock index funds has trading costs equal to its expense ratio (0.95 percent), and the bond index fund has trading costs of 0.5 percent, or about 70 percent of its expense ratio.

Finally, the returns on each of the two funds in our model's hypothetical 401(k) are set to the historical returns earned by each asset class in each year, compounded annually, minus fees and inflation. For its stock index fund, we use the real return of an S&P 500 index fund less fees and inflation; for example, in 1989, the S&P 500 index increased by 22.01 percent, and thus our stock index fund returned 14.57 percent, real, after fees and inflation of 4.83 percent. Similarly, its bond index fund, which we assume to be invested equally in U.S. treasury bonds (10- and 30-year) and corporate bonds, produces a return that is the average of the treasury rate and a corporate bond index rate; for example, also in 1989, the bond index fund earned a return of 8.68 percent, nominal, and 2.43 percent, real, after inflation and fees. Each earner's yearly portfolio balance, both before and after fees, is show in Figure 7.

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13 Financial and Life Concerns of Baby Boomers

Life choices can be difficult. This list can provide you with a guideline to help organize your choices and to help you in your personal evaluation.

1. **Inflation:** Have you lost your purchasing power? Inflation is the number one reason why seniors have trouble continuing their retirement. How do you make sure your money lasts as long as you do? In the past, financial planners have suggested that 4% systematic annual withdrawal of your retirement assets as income was sustainable. No more. With interest rates at an all-time low and fear of inflation, retirement income sustained over a long period of time is a concern.

   A solid way of understanding inflation is postage; remember when a US postage stamp was 23 cents? How much does it cost to mail a letter today? The government tracks inflation through the Consumer Price Index (CPI), what is not included in the CPI inflation index calculation is food, clothing and energy, all have been omitted.

   Everything you will ever want to know about CPI can be found at this link: http://www.bls.gov/cpi/

2. **Banks, Certificates of Deposit, FDIC:** Are you earning the highest available interest rate? To understand how the banking interest rate system really works you have to do research. Ask your local bank what is their "promotional" interest rate for new depositors. Often interest rates for new depositors could be higher than current interest rates for continuing customers.

   The internet also is also a source for better CD rates; www.bankrate.com is a dependable reference source. Make certain your funds are insured through FDIC, limits have changed in the past; it is wise to make sure your accounts fall within the insured limits. Also ask you bank for the FDIC brochure, which they must provide to you. Another good tip on interest rates is to not be bound by "brick and mortar." It no longer matters if you

bank with a local bank or a national bank, it is all about interest rates and whoever pays you the highest rates should get your business.

Here is the link to the FDIC website: http://www.fdic.gov/

3. **Annuities:** How they can work for you and how they can not work for you. Annuities fall into the category of "confusing" because there are so many different types of annuities available. Annuities can be sold by banks, insurance agents, financial planners and security licensed sales people.

Annuities fall into one of two categories, those that are securities and those that are insurance products. The security type of annuity is called a variable annuity, in a variable annuity your funds are invested in mutual type products known as "sub-accounts". These accounts can increase and decrease based on market conditions and contains annual fees (based on the contract). Variable annuities have fees, fees for the contracts and fees for the money management. Make sure you fully understand them before deciding on purchasing an annuity.

A good source of information about variable annuities can be found from the industry overseer itself FINRA, link: http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/AnnuitiesAndInsurance/p005976.

Fixed (or interest bearing annuities) are insurance products sold by licensed agents, these products are under the authority and regulation of each individual state insurance department. . Many variations of these types of annuities exist, including short term and long term contracts. Fixed annuities charge no fees and have no expenses. A good source for fixed annuity information: www.annuity.com

4. **Wrong Time Horizons.** Do you want to outlive your money or have your money outlive you? While this may seem an easy answer, it is not. Because no one knows for sure how long life will be. Retirement planning takes careful analysis and planning. Probably the very biggest error made in financial planning is not carefully considering their **"time horizons."** By definition a time horizon when speaking of financial uses is the length of time a sum of money is expected to be invested before being used for a specific goal, such as retirement. If our time horizon is next year then options are less and if our time horizons are further in the future, options increase.

There is an old saying that best describes life expectancy, *"The longer you live, the longer you live."* Nothing could be truer, so how do you make certain your funds will last as long as you do? That is the hard part, considering the best options for you really depend on your personal situation.

First assess your retirement goals, then be honest with yourself about a sustainable budget, and then have a serious look at your assets. With the funds last as long as you last? That is a tough question and there is no absolute answer. Many people "outsource" the responsibility to a risk bearer (an insurance company) who will manage your funds and provide you with an income. But, other options do exist, it really all depends. It depends on you and your goals and desires. One rule of thumb is your time horizon, a simple example is bank CDs, a one year CD might pay 1% interest but a five year bank CD might pay 3%, so by looking longer more interest could be earned.

5. **Are You Paying Too Much In Taxes?** The number one tax mistake made by American taxpayers is simply paying taxes on yields that can be deferred to a future tax year. Did you know that you can reduce your taxes on social security by rearranging how your interest on bank and other deposits is taxed? As an example, if your funds are earning interest at the bank, you are taxed at ordinary income rates. The income is also used in calculating your income tax rate on your social security benefits. If you allow an insurance company to hold your funds in an annuity, the income is not reportable for tax liability (until touched) and it lowers your tax rate which could change the tax liability on your social security. Here is more information: http://www.socialsecurity.gov/OACT/ProgData/taxbenefits.html

6. **IRA:** The IRS has new rules; do you understand how it affects you? Did you know you can rollover your old 401(k) to a self-directed IRA without tax liability? Did you know you can convert your IRA to a pension that you can never outlive? And include your spouse? An IRA is normally your weakest asset because tax has not yet been paid on the accumulated funds. If you allow your children to inherit your IRA, new IRS rules apply to minimum withdrawals and deferral. Also, you can generation skip to your grandchildren and "stretch" your IRA and its tax liability far into the future. Being up to date with options in your IRA can have a massive effect on you and your heirs.

Many mistakes are made by not designating the correct beneficiary to your IRA, as an example, if you designate your estate as the beneficiary, all the taxes may be due in a shorter time period. Another error could be not naming "contingent" beneficiaries of your IRA, as protection in case the primary beneficiary dies before you. Here is information about IRAs from the IRS: http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-IRAs

7. **Additional Retirement Income:** A new program for seniors, can it benefit you? This program was created in 1988 and designed to help seniors protect their assets and income. Reverse mortgages can allow for income to be released from your accumulated home equity and not affect your ability to remain in the home, plus the income is not taxable. Reverse Mortgages are federally insured and federally guaranteed. Contrary to what many people think about reverse mortgages, you are not signing your home over to the government, any equity you have in the home is either yours or your heirs. (inheritance). Find out more at HUD: http://www.hud.gov/buying/rvrsmort.cfm

8. **Commissions, Fees, Expenses: Mutual Funds.** Are they a smart investment or a sucker? Because of the nature of our financial markets, we are subject to fees and expenses often at times without our awareness. f you own mutual funds or use bank products and don't understand how they really work, pay attention. Information is the key and being informed is essential to your long term financial health.

Your mutual fund contains fees for acquisition, maintenance and in many cases on going commissions paid to the original sales organization for as long as you own your mutual fund. Have you not been informed by your broker? Yes you were when you were handed the prospectus. Being direct with your broker about what fees, charges and expenses being subtracted from your mutual fund can help you make an informed decision.

Fees are: expense ratio (cost of operating fund), 12 b-1 fees (trail commissions paid annually), loads which are acquisition expenses paid to acquire the fund. Addition, the *turnover rate* of the fund can help learn about the tax efficiency of the fund, the lower rate means less buying and selling of assets in the fund.

The mutual fund industry monitors itself through FINRA (Financial Industry Regulatory Authority), follow this link to find out more about mutual fund expenses.
http://www.finra.org/investors/smartinvesting/gettingstarted/podcasts/mutualfundsetfs/p123179.

Concerned about who you are doing business with? Want to check on your broker and make sure? Just imagine how much an extra 1% earned over an IRA's lifetime would mean to you and your family. Reduce your fees and keep more for yourself.

FINRA also allows you to check on your broker through this link, find out if he or she is who you think they are:
http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015184

9. **The Market:** The Dow Jones Industrial Average, the S/P 500 Index. Do you understand how the market really works?

The Dow Jones Industrial Average is a collection of 30 large American stocks which represent the American economy sectors. It is an index that shows how 30 large publicly owned companies based in the United States have traded during a standard trading session in the stock market. The Standard and Poor's 500 is a larger number of companies (500 American companies) representing all aspects of the American business economy.

Both indexes along with others (NASDAQ) help gauge our economy's growth. Many investors buy the index to spread risk and to replicate with their own investments the American economy's performance.

Here is a link to an easy to understand guide to investing in indexed:
http://www.fool.com/60second/indexfund.htm

10. **Protecting Your Assets**. Where there is a will there is a way. Understand how trusts, wills and probate really work.

Probate in its simplest form is the retitling of assets. Think of the title to your car, if you sell the car the title needs to be transferred to the new owner, so ownership is transferred. That is how probate works, merely the retitling of assets from owner to heir at death. The cost of probate varies between states to state and the value of the estate being transferred.

Here is the best resource for basic information on avoiding probate:
http://www.amazon.com/Understanding-Living-Trusts-Avoid-Probate/dp/0945811225

11. **Health Care Catastrophes.** Medicaid, Medicare and long term care insurance. Do you know the difference? Are you are concerned about protecting your assets from health care catastrophes? The government allows for certain assets to be protected, are you informed?

Simply stated, Medicare is health insurance in which premiums must be paid, Medicaid is health insurance offered as charity. Medicare does NOT pay for long term care needs in a nursing home; Medicaid will help with long term nursing costs if no other option exists. Medicare is administered nationally; Medicaid is administered by each individual state.

Long term care insurance is available for qualified applicants based on the individual's current health issues and the insured must pay premiums. Premiums are paid to an independent insurance company and in return protection of expenses in a nursing home is offered. Long term care insurance premiums are NOT guaranteed and may increase based on the insurance companies claim paying needs.

The government offers information regarding long term care insurance at this link: http://publications.usa.gov/USAPubs.php?PubID=5879

Medicaid information and information based on what your state of residence allows for protected assets can be found at this link which is based on your state of residence: http://www.elderlawanswers.com/

Medicare information can be found here: http://www.medicare.gov/

12. **Asset Protection Plan:** On sale at your attorney today. Want to know how it works? Elder Law Attorneys know how to use this to protect your assets.

In most states it is possible to protect assets for the well spouse in the event of a long term care need (ill spouse). The amount which can be exempted from spend down rules varies from state to state. Here is more information: http://www.elderlawanswers.com/medicaid-protections-for-the-healthy-spouse-12019

Many attorneys specialize in asset protection using these legal available options. Often called *Asset Protection Plans*, they are also known by many other names. What an Asset Protection Plan refers to is how to protect legally assets which can be transferred to the well spouse.

13. **Procrastination:** You can plan now or you can plan later. Benjamin Franklin once said *"the number one problem facing Americans today is…procrastination."*

We are all victims of procrastination, so how best can we move forward?

One first step to take a complete inventory of your overall assets and what you want them to accomplish. Being direct with yourself and knowing your retirement needs and your time horizon (see number 4 above) is essential and a good first step.

The great Napoleon Hill said it best: *Procrastination is the bad habit of putting of until the day after tomorrow what should have been done the day before yesterday.*

Here is a list of resources for specific topics:

Bonds: http://www.finra.org/Investors/InvestmentChoices/Bonds/SmartBondInvesting/Introduction/
Bank Products: http://www.finra.org/Investors/SmartInvesting/ChoosingInvestments/BankProducts/
401 (k): http://www.finra.org/Investors/SmartInvesting/Retirement/Smart401kInvesting/Introduction/
College Funding: http://www.finra.org/Investors/SmartInvesting/SmartSavingforCollege/P123940
Annuities: http://www.annuity.com/

Want more information, email us at info@annuity.com and we will send you the name and contact information of an authorized and licensed local agent. He/she should be able to answer many of your questions.

Disclaimer: Important decisions should not be made without consideration of all aspects such as tax liability, investment options and risk assessment. Always consult a licensed professional before making any long term decisions. The list above is meant as a guideline to provide ideas and options for you to consider when evaluating your situation. Seek professional advice.