

April 7, 2006

Dear Board Member,

My name is Bruce McNutt and I have been teaching math at Wayne Hills for 13 years. I am also a Wayne resident. I am writing each board member regarding an issue I am having with our current 403(b) plan in the Wayne School District.

Before I begin please allow me to apologize for the bad timing of this letter. I know you are all very busy with the budget and reelections, but I really don't feel I can wait any longer to address this issue. Also, in advance, thank you for taking the time to read this.

I am trying to get some alternatives to our current 403(b) providers because I believe there are companies out there that could better serve the employees of the District. In October we sent a list of 25 signatures to the Board of people who were interested in having Vanguard added as a provider in the district. After that request was denied, I inquired as to why. I was told by Central Office that the Board thinks there are enough choices already and it is too much paperwork to add a new provider. I agree we have many choices. The problem is I don't think the choices we have are the best choices available. I asked Mr. Ottman if I could make a presentation to the board to show why I think there are better choices and I was again told that the Board is not interested in adding additional providers at this time. I was also told that every two weeks there is someone else wanting to add another provider and the board can't possibly add every company.

As for the matter of too many choices already, my response is "how could we possibly have too many choices." We boast as a district about offering 32 A.P. classes in each high school, of which I am a teacher of one and I boast too. But isn't the point of having 32 A.P. classes all about offering choices. Would you say we aren't going to add another A.P. class because there are already too many choices? The whole point is to offer many choices, so that each individual can find the program that best suits them. The same is true for 403(b) providers as well.

Had I been given the opportunity to make a presentation to you, I would have made what I feel is a very strong case for allowing a new provider. Since I was not given that opportunity, I am going to write you my presentation instead. Trust me, I am more interesting in person, but since I don't know how else to make my case, I am sending you this letter.

Please keep in mind a couple things as you read this. First of all, this is not a personal thing. I am not doing this just because I think it is best for my own family. I am doing it because I feel it is in the best interest of the entire workforce employed by the Wayne Board of Education. Also, I am not the only one who feels this way. I have had many discussions with many staff members and a lot of us feel this is in our best interest. I told them that I can't imagine that the Board would resist allowing another provider and to be frank, I am surprised by the Board's reluctance on this issue. To be perfectly honest, I

have no idea what the big deal is, but none the less, this is the information I would have presented.

I don't know what everyone's investment background is so I would first have offered some information on what a 403(b) is. A 403(b) is a retirement plan set up by the government to encourage people to invest. Like an IRA, there are penalties for early withdrawal so this is an investment vehicle that encourages people to save for the long term. The most enticing thing about a 403(b) is that contributions are tax deferred, which means that you do not pay federal income tax on the money you put in. Furthermore, the contributions you make are done through an automatic payroll deduction which makes it attractive to people because they can set it up and then forget about it. Once the money is placed into a 403(b) there are many options as to how you specifically invest the money. You can invest in stocks, bonds, etc.

If you aren't familiar with the specifics of 403(b)'s you may say "what difference does it make what company you invest with," but the company you invest with can make all the difference and here is why.

The companies that the Wayne BOE has decided to allow as providers are a mix of insurance companies and financial companies. The insurance companies include AIG Valic and AXA Equitable. Most people who I have talked to are invested with these companies. There is also one financial institution that I know of and that is TIAA-CREF. In my opinion, this does not really represent much of a choice, because if I opt to invest with a financial company I really only have one choice, but more on that in a bit.

The insurance company's major offering as an investment choice is what is called an annuity. Many people don't know what an annuity is so allow me a moment to explain them. An annuity basically guarantees that if you die, the total amount of money you put into your 403(b) will be guaranteed to your beneficiary at death. For example, assume that for the last ten years I have been contributing \$8,000 each year into my 403(b). Furthermore let's assume I have been investing it in a standard fund such as an S&P 500 fund which basically invests in the largest 500 companies in the United States. This type of fund is a very standard fund for a person in a 403(b). Since I have been investing \$8,000 per year for 10 years I have invested a total of \$80,000 into this fund. If I were to die tomorrow, my annuity guarantees that my beneficiary will receive at least \$80,000. If my total investments were to go up, let's say to \$95,000, then my beneficiary would receive all \$95,000. If let's say my investment had lost value and fallen to \$70,000, my beneficiary would get \$80,000 because that is the amount I have put into the account. It sounds like a great deal but allow me a moment to explain why it isn't.

Using some basic rules of probability, in order to calculate the probability that two independent events both occur, you multiply their probabilities together. For example, the probability I toss a coin and get a head is $1/2$. The probability I roll a die and get a 2 is $1/6$. The probability that I toss a coin and get a head, and at the same time I roll a die and get a 2, is the product of their probabilities. In other words it is $1/2 \times 1/6$ or $1/12$.

Now let's apply this same principal to an annuity. In order for me to cash in on an annuity two things have to happen. First I need to die, and second my account has to be

worth less than the total amount of money I put in. So let's calculate the probability that both these things occur. First the probability that I or anyone else under 50 years of age dies in the next ten years is probably about 1 in 1000. The probability that I invest \$8,000 dollars in the broad stock market over the next 10 years and my account is worth less than \$80,000 is difficult to figure because *it has never happened*, so an aggressive estimate is around 1 in 1000 as well. When you multiple these probabilities together $1/1000 \times 1/1000$ you find that an aggressive estimate for the probability I cash in on my annuity is around *1 in a million*. As a general rule, people in our position, that is those of us under about 60 years of age; have no business putting their 403(b) in an annuity. If you don't believe me though, take this information to financial advisors and let them read it and see if they can refute it.

Even worse though is that annuities are extremely expensive. I won't bore you with the calculations, although I would be happy to share them with you, but over the course of these 10 years, it is going to cost me around \$500 per year for the annuity portion of this investment. I will pay \$500 per year to protect against an incredibly unlikely drop in my investment. Think about it, what is the most my investment could possible drop? Since these investments have never dropped over a similar time period this is tough to estimate, but let's say the stock market has a terrible 10 years, the worst since 1929, and my investment drops to \$70,000, if I die, my wife will get the \$70,000 anyway, plus a check for an additional \$10,000. That's nice but I just paid \$500 per year for ten years to get that \$10,000. Some deal. By the way, I pay around \$500 per year for a \$2,000,000 life insurance policy should I die, that's what it means to protect your family.

Based on the above information, I believe that it is pretty clear that for the *vast* majority of teachers in the Wayne school district, an annuity is a terrible way to contribute to a 403(b). Because of that, any company that only offers annuities to me is no choice at all. Since all but one of the companies Wayne has chosen to be 403(b) providers offers only annuities, the only choice we really have is TIAA-CREF.

As far as TIAA-CREF goes, it's a solid financial institution with a broad mix of investment choices. My problem with CREF is that there are other financial institutions that offer similar services at a lower rate. To compare CREF to similar financial institutions let's once again consider an investment in an S&P 500 fund. It doesn't matter what company you use to invest in the S&P fund, you are investing in the companies of the S&P 500, not the company that provides the service of the investment. Just like I can buy a Honda Accord at Tom's Honda or Fred's Honda, it's the same car. So all else being equal, where would you buy your Honda? I know I would buy it where they had the lowest price. The same is true for investing. If I am going to invest in the S&P 500 I am going to go where the cost is the least. In investing, this cost is referred to as the expense ratio. The expense ratio and TIAA-CREF for an S&P 500 fund is .34%. This means that every year they take .34% of the total amount of money you have invested. .34% by the way is pretty good, especially since at Valic, the same fund with an annuity is about 1.4% or more. .34% isn't the best price however. Companies like Vanguard and Fidelity offer these same funds for less. For example, at Vanguard, the expense ratio on the 500 fund is .18%. Now you may ask, "What's the big deal? .18% is not that much less than .34%" In actuality however it is. Just for comparison, on a \$100,000 initial investment earning

9% for twenty years, the difference between an expense ratio of .34% and .18% is around \$41,000. Yes that number is really \$41,000.

As I write this I repeatedly ask myself, "Why in the world would the Wayne Board of Education possibly not want us to have the best choices possible." My personal belief is that maybe not everyone on the Board has done the research into 403(b)'s like I have, and don't really understand the ramifications of the choices they provide. This research represents me caring about my family, and like you, I love them and want to provide for them the best I can. Not only for today, but into the future as well.

As for the matter of every two weeks there is someone else wanting a new provider, I have been here for thirteen years and to the best of my knowledge there has never been a new provider added during those thirteen years. I would also be surprised if most of the requests for new providers are companies other than Vanguard or Fidelity. I asked Mr. Ottman if he had kept track of what companies were being requested and he replied that the board was not interested in adding new providers.

I appreciate that the result of adding a new provider is additional paperwork for the already overworked staff in Central Office, but I hope you can appreciate that limiting our choices to insurance companies and higher priced financial institutions results in the loss of *hundreds of thousands, if not millions of dollars* over time to the employees of the Wayne Board of Education.

I sincerely appreciate you taking the time to read this letter. Trust me, it would have been more interesting in person, but like I said, I was not given that opportunity. If you research anything I have written in this letter and find it to be false, please inform me. One of the reasons I wanted to meet in person is that I'm sure I could learn a lot from all of you as well. If you research the information in this letter and find it to be true, please reconsider allowing Vanguard to be added to the list of 403(b) providers in Wayne. My family, and many like mine, will thank you for years to come.

I will anxiously await the Board's reply, and please feel free to contact me with any questions.

Sincerely,

Bruce McNutt

Wayne Hills High School