Bogle: U.S. Retirement System a 'Train Wreck'

By Christine Benz | 10-18-2012 08:00 AM

Christine Benz: The last thing I would like to cover with you, Jack, is our retirement plan system. I think we can agree probably that we have this looming catastrophe with people so far undersaved for retirement, the great 401(k) experiment for many folks has not gone well at all and you do discuss the retirement system in the book [*The Clash of the Cultures*]. Let's discuss from your viewpoint where we've gone wrong and what steps we can take to get things back on track?

Jack Bogle: In the book I call that with typical understatement, "a train wreck" or "a coming train wreck." Let me take it in two sections, one is the defined-benefit area, the pension area, which as we all know is shrinking, but still these pensions, state and local as well as corporate, are assuming almost universally 8% returns in the future. In a standard portfolio that we talked about earlier, stocks give you 7% and bonds give you 2.5%. Their returns on the market side of a balanced portfolio, a very important point, are going to be, let me say 4%. And then you're going to pay for that, and you're probably going to pay 1.5%.

So now you're down from 4.0% to 2.5%. You said 8%; it doesn't wash. And there are ways to get around it. Buy hedge fund managers--unproven and seemingly not doing so well. You can go private equity. It's never been a license to steal for the investor. So much money comes out of the private equity system. The people that are in it make an awful lot of money, but as always the client comes last. So the 8% is not going to happen. I say that absolutely unequivocally. So we a have a big thing to fix there, and it's going to cost corporations a lot of money at some point. They keep pushing it, and I'll say kicking the can down the road. But the 8% still stays there in the face of overwhelming evidence, but it's a joke. And so [the defined-benefit plan managers look to] speculation to get 8%, speculation over investment again, and they're doing more and more of that, more and more private equity, more and more hedge funds. And it has to end badly unless the corporations just say "Stand up and take the loss."

On the defined-contribution side, the biggest problem is, I don't know why there's not enough awareness of this. . . By the way a defined-contribution plan has been available since the beginning of time. I had been in one from the day I started at Wellington Management Company in 1951, put 15% of my pay away in Wellington Fund, and I've been doing it ever since. It's worth a lot of money. I couldn't help it. Low-cost funds, conservative mostly, equity-based at the beginning, bond-based at the end. So it's not very complicated. But in 1982 when we had the 401(k) ruling, that was to create a thrift plan for employees. You can't turn a thrift plan into a retirement plan. I know we're trying to, but it's still much too easy to take money out, much too easy to borrow against, much too easy when you get fired or move on to another job to take the proceeds and not roll them over, but buy some other things you need or want for a long time.

Imagine Social Security if there's a little paragraph in [the rules] that says, "By the way, whenever you want to any money out, be my guest." How big would your

account be? So, we have to restructure the system. We've got to have, I talk in my book about, a federal retirement board to control access to an integrated retirement system where all these As and Bs and Ks and 3s, 401s and IRAs are in a single unit and you can bring in different streams of money from your corporation or your own savings into that unit and then decide what it is you want to buy. Everybody knows that you're going to end up with one great big index fund because there's just too much money not to.

However, there are two ways to do that. If everybody makes their own picks, with their own free will, they will own the index fund. I mean, people own a lot more IBM than some little tiny computer company in Des Moines, Iowa, or wherever. So, you end up with an index fund, and the question is, are you going to buy the index fund and pay 3 basis points a year for it, or are you going to buy a whole lot of components and pay 200 basis points a year for it? The answer is obvious. So, we ought only allow participants in that system who are basically investing rather than speculating, who are running at a very low cost--nobody can beat the Vanguard cost, of course, so we can't set that as a standard--but some really low cost to take the advantage of this integrated system.

And then then limit withdrawals harshly. People aren't going to like that, but you're either going to save for your future or you're not. There's a deeply touching story in the book, an anecdote from Joe Nocera, who wrote a great mutual fund book around 1990 and then went onto the financial page of *The New York Times* and then to the editorial board of *The New York Times*. A very smart guy. He writes a column on the editorial page, probably three times a week. And he tells a story about his 401(k), and he got on the boom and. . .

Benz: Real estate, as well.

Bogle: Yes, and real estate. And then [the market] collapsed, and then he needed a little money to rebuild his apartment or something. So he took that [money] out. Then he got divorced and lost half of it, and he says, he is down to zero. He is never going to be able to retire. There's something wrong with that, and it's all the errors people make, chasing the past winners, speculating--and speculation comes into all of this--whether it's corporations speculating on earning 8% or individual speculating on the Golconda or something.

So, the system needs to be fixed. Social Security needs to be fixed. There, we're speculating that the payments will continue essentially, but they're not going to be unless we take some very simple, gradual fixes to the system. And in the book I offer to be the czar. I don't think anyone's going to take me up on that, but basically if you had political freedom, you could fix a system in somewhere between a half an hour and a week.

Benz: Political freedom is the big issue though.

Bogle: Oh, yeah.

Benz: Well, Jack, thank you so much. It's always great to hear your insights. Thanks so much for being here.

Bogle: My treat. Thank you, Christine.