Mr. Smith Goes to the Patent Office

By Editor Test *Wed, Jul 7, 2010*

An actuary-turned-entrepreneur claims to have invented a cheap, benign, versatile new income distribution tool. But he's coyly cryptic about its secret sauce.

Ron Smith, a New York-based actuary who once worked in Vanguard's 401(k) division, applied for a patent last January for a simple but revolutionary retirement income distribution tool that uses only mutual funds and not insurance or derivatives.

But that's almost all he's willing to say about it right now, pending discussions with major mutual fund providers about licensing his intellectual property, whose service mark is LISA, for "Lifetime Income Stream Accounts." The e-press release that his startup firm, Ovacurrus LLC, broadcast this week was coyly cryptic.

"Obviously, since we filed for a patent, we think it's unique," Smith, a graduate of Brown University, told RIJ over the phone. "But I can't tell you more in detail. The people who may eventually be our clients have agreed not to discuss it. So it wouldn't be appropriate for me to talk about it."

One could only speculate at whether this announcement constituted rumor or news. Could Smith's brainchild be a high-tech tease, like cold fusion? Or a cheap, benign and versatile remedy like Simple Green?

The latter, Smith claims. He said it is related to target-date funds, would be a Qualified Default Investment Alternative for 401(k) plans, can provide direction during both the accumulation and distribution phases, and would add only a basis point or two to the cost of the underlying fund investments.

"This is not an annuity product," he said. "It involves no derivatives, no hedging. But it does allow you to accomplish the same goals in a mutual fund environment. There are some market volatility controls in place, but it doesn't tie money up. You can change your mind. You can change your mind." It's not a new kind of payout mutual fund, either, he said.

So what is it? "As details come out, it will seem pretty intuitive. There are no gravity-defying effects going on. Most people will say, 'How obvious.' They will be more likely to say, 'Why didn't I think of it?' than 'This guy's an alchemist.' But it's only obvious if you look at things different from the way people have been looking at them.

"It's an approach to providing lifelong retirement income without insurance products, using traditional investments. The product is designed for the person who wants $10,000 one year, $10,200 the next year and $10,400 the next, and so forth, using relatively traditional mutual funds. You couldn't walk into a mutual fund company and do this today, but a Fidelity or a Vanguard could have these types of products fairly soon," he added.

In looking for licensees, Smith is talking to mutual fund companies with early-adopter rather than fast-follower product development cultures. “For the fund companies, this would be an attractive alternative to guarantees or annuities.”

“Insurance companies that have large mutual fund operations may be interested in this. They’ll have to come to grips with whether they want creative destruction to enter the picture. If they try to protect their franchise, we’ll be a competing product. Or we could be a complimentary product. But we’re not focusing on the insurance companies,” he told RIJ.

“It will involve some tool building, so that investors can use it directly. For plan sponsor recordkeeping systems, some modest adjustments may be necessary. This will work for active 401(k) participants as well as retirees. It’s designed to be a QDIA. It also fixes a lot of the issues that people have with TDFs. It’s not just a tweaked version of the 4% systematic withdrawal method.”

LISA addresses longevity risk, capital markets risk and inflation/interest rate risk. It doesn’t help address the problem of under-saving for retirement (as life annuities can), except to the extent that it can guide 401(k) participants during the accumulation stage.

“One of the criticisms of the current 401(k) plan design is that you have 30-year-olds contributing six percent of their pay and maximizing the company match and thinking that’s all they need to do. They don’t understand what their deferrals and matches will provide in terms of retirement income. In a straightforward manner, LISA translates the person’s balance of $50,000 or so at age 30 or 40 into an income stream at age 62 or 65, and suggests appropriate ways to invest it until then,” Smith said.

“Today’s calculators can tell a 30-year-old that if you save 6% and it grows at 8%, you’ll have $800,000, for instance, at retirement. But they can’t’ tell you what the purchasing power of $800,000 will be after inflation. For the 65-year-old with $500,000, LISA says, here’s the income that $500,000 will provide. It also recommends ways to invest the assets. It acknowledges that you have to be at least partly invested in equities during a 20-year or 30-year retirement. The opportunity costs of being invested entirely in bonds at age 60 are just too high.”

Smith hopes to complete one or more licensing deals for LISA in the next six months. “Overcoming the ‘not invented here’ barrier [at fund companies] can be a problem, and people have heard the ‘new and improved’ claim so often that there’s a natural level of skepticism,” he told RIJ. “But I’m hoping that as companies do feasibility studies, it could be in place by year-end 2010.”