Investment & Retirement News

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Independent, Objective Advice

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Financial reform: the table is set

Congress agrees on a bill. How would it change the financial landscape?

Next month, President Obama will likely sign a bill into law ordering changes in the ways banks, credit card issuers and mortgage lenders interface with consumers. Here are the key features of the financial reform agreement that the Senate and House of Representatives came to on June 24, with a vote pending.

#1: The Bureau of Consumer Financial Protection. This new consumer agency answering to the Federal Reserve would supervise mortgages, credit cards, student loans and the banks, credit unions and private lenders that issue them. Institutions holding less than $10 million in assets wouldn't be regulated by the BCFP – but they would have to follow its rules. The BCFP would aim to make these products easier to comprehend for consumers and crack down on any possible deceptive practices.[1,2]

#2: See your credit score for free. If you are turned down for a mortgage or a loan, the new reforms would give you the power to see the credit score supplied to your lender. Right now, you can request three free credit reports each year but you can't see your actual score.[1,2]

#3: Tougher rules for mortgage lenders. These rules should have come into play years ago, of course, but better late than never. Mortgage lenders would need to verify the assets and income of borrowers, thwarting any surreptitious comeback for "liar loans". Loan officers and mortgage brokers would not be able to receive bonuses for guiding you into this or that loan. Borrowers with ARMs and other types of complex home loans could not be hit with prepayment penalties should they want or need to pay off a mortgage before the end of its term.[1,2]

#4: Retail minimums for the use of credit cards. Score one for retailers, who don't want to see people make $2 credit card purchases when the swipe fee alone cancels out the revenue. Under the new legislation, stores could set minimums for credit card use. The minimum transaction level could be as high as $10 if a store chooses; the Federal Reserve could raise that $10 limit on the minimum with time.[1,2]

Alternately, stores could offer consumers discounts if they pay for items with cash or debit cards. (They wouldn't be able to vary the discounts for different debit cards.)[2]

Additionally, the proposed reforms could allow colleges and universities and the U.S. government to set maximums for credit card transactions.[2]

#5: Brokers could be held to a fiduciary standard. Under the new reforms, the Securities and Exchange Commission now has the chance to hold brokers to the same fiduciary standard common to financial advisers – that is, investment brokers would have to put a client's best interest first and not simply recommend a "suitable" investment to a client. That new standard may or may not come into play, however; the SEC is undertaking a six-month study to see if such a rule would amount to regulatory overlap or not.[3]

#6: The "Volcker Rule" would be put into play. This is the rule that would prevent banks from trading with their own money. It would kick in with small concessions. While the reforms would halt most proprietary trading by banks, some limited investment would be permitted – they could provide up to 3% of a fund's equity, and invest up to 3% of Tier 1 capital in hedge or private equity funds.[4]

The big banks got another key concession from Congress: they don't have to get rid of their swaps-trading desks (some legislators had contended that this decision would drive such trading to foreign markets). They can still be involved in foreign-exchange and interest-rate swaps dealing.[5]

#7: An Office of Credit Ratings would appear. It would oversee the actions of Moody's, Standard and Poor's and other big names, and one of its objectives would be to flag potential conflicts of interest that could influence ratings judgements.[1]

#8: The SEC would no longer regulate equity-indexed annuities. The promotion and sale of these annuity contracts has generated much flak in recent years. Interestingly, they would be overseen by state insurance regulators if the reform bill passes, and treated strictly as insurance products.[2]

Now, what about Fannie Mae and Freddie Mac? Good question. Nothing made it into the final reform bill to address that dilemma. Some analysts expect another bill will emerge in 2011 to propose their restructuring or elimination.[5]

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Taxing the rich to pay for health care

That's part of the plan. How will you be affected?

In 2013, wealthy Americans will pay extra Medicare taxes. Congress, President Obama and the IRS are putting a surcharge on the wealthy to help fund the health care reforms.

- Beginning in 2013, joint filers with adjusted gross incomes of $250,000 or greater and single filers with AGI of $200,000 or greater will have to pay 0.9% extra in FICA taxes (that is, Social Security and Medicare taxes). The employers of these taxpayers face no such increase.[1]

- Also, joint filers with modified adjusted gross income (MAGI) of $250,000 or more and single filers with MAGI of $200,000 or more will be docked with a 3.8% tax on investment income. (Even estates and trusts will be subject to this new 3.8% levy.)[1]

What might the dollar impact be? The Tax Foundation, a politically conservative watchdog organization, thinks that the richest 1% of American families will pay an average of $52,000 more in federal taxes by 2016.[2]

What are the chances of these tax hikes being repealed? Think slim and none. Basically, you'd have to repeal the health care reforms to make it happen.

How can you avoid the 3.8% tax on dividends, capital gains & interest? It won't be easy. Real estate investors may luck out the most, because federal law characterizes rental income as "active" rather than "passive". On the other hand, if you sell a home you've owned for decades and see a taxable gain above the home sale exclusion ($250,000 single, $500,000 married), you'll face the 3.8% tax.[1]

Some forms of unearned income won't be slapped with the tax. IRA distributions and income distributions from 401(a), 403(b) and 457(b) plans will be exempt. The same goes for pension income and Social Security income. Annuities that are part of a pension plan will be exempt. Any income from a business that you participate in won't be hit with the 3.8% tax. Veterans' benefits, life insurance payouts and interest earned by municipal bonds will also be spared.[1,3]

As a result of this tax, you might start to see subtle shifts in financial strategy. You might see more muni bond purchases, more interest in life insurance, and more installment sales. As qualified Roth IRA distributions don't boost AGI, you might be looking at another factor promoting Roth IRA conversions.[3] Everybody will think about taking some capital gains prior to 2013.

The richest Americans have paid less tax in recent decades. Wealth for the Common Good (a liberal non-profit looking at this matter) notes that in 1955, the 400 largest incomes in America paid 51.2% of those incomes back in federal taxes. That led to the "tax shelters" of the 1960s and 1970s. In comparison, the top 400 incomes in America in 2007 paid out only an average of 16.6% in federal taxes.[2]

So how can you reduce your taxes in 2013? It is not too early to think about it. You might want to devote a planning session to this topic, or start to read up on your options.

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Quicken downloads!

Oaktree Financial Advisors, Inc. is happy to announce that clients with Pershing brokerage accounts can now download their activity into Quicken!

In order to download into Quicken you will need to have online access through NetExchange Client setup. If you access you accounts by going to tfa.transamerica.com/client you are ready to go. If you do not have online access to your accounts already setup please contact our office so we can get you a user id and password.

Instructions from within Quicken:

1. Select "NetExchange Client" as the Financial Institution.
2. Customer ID Field
   The client will enter the financial organization number (4H8) followed by their NetExchange Client user ID
   For example, if your user ID is "johndoe" and the financial organization number is "4H8," the client will need to enter this information as "4h8johndoe" in the customer ID field.
3. Password
   Your password is the same as you use to log into the tfa.transamerica.com/client or NetExchange Client website.

If you have any questions or problems please let us know.

Marginal tax rates for the affluent are nearly half of what they were 30 years ago

In 1979, a household with taxable income equivalent to $150,000 in today's dollars had a marginal tax rate of 54%, compared to 28% in 2010.

- Two congressional acts were primarily responsible for this reduction in rates
  - *Tax Equity and Fiscal Responsibility Act of 1982* – reduced the highest marginal tax rate from 70% to 50% and the number of tax brackets from 16 to 13
  - *Tax Reform Act of 1986* – reduced the highest marginal rate from 50% to 31% and the number of tax brackets from 12 to four by 1990.
- Since 1990, the top rate has increased to 35% and number of brackets has expanded to six.

Relative to 30 years ago, affluent investors are keeping a far greater percentage of their income to spend, invest and give away.

Source: The Tax Foundation, U.S. Federal Individual Income Tax Rates History

Love Means Never Having To Say You're Underdiversified

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What's Inside…

Investment & Retirement News

"(Human flight in a machine) might be evolved by the combined and continuous efforts of mathematicians in from one million to ten million years."

- from an article in the New York Times, October 9, 1903

"We started assembly today."

- from the diary of Orville Wright, October 9, 1903

If you are not yet a client and would like to see how a relationship with Oaktree Financial Advisors can benefit you, please give us a call at 317-818-1631 to schedule a free introductory consultation or join us for one of our workshops.

The purpose of our workshops is two-fold. First, we schedule these events to provide valuable information on financial matters important to you. Second, the workshops provide a relaxed atmosphere to learn more about Oaktree Financial Advisors, Inc. and our philosophies.

Visit our website at **www.oaktreeadvisors.com** for details and reservations.

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