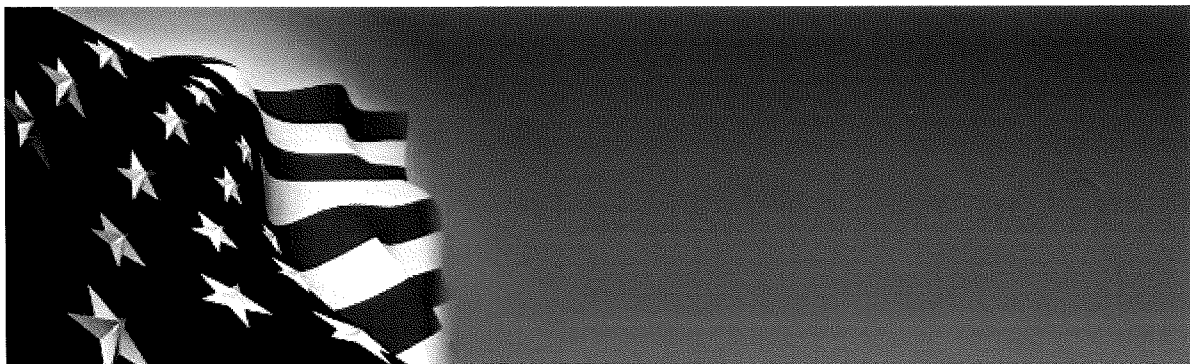


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CYPEN & CYPEN NEWSLETTER for OCTOBER 9, 2014

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. ENTITY ONLY FIDUCIARY TO EXTENT IT POSSESSES AUTHORITY OR DISCRETIONARY CONTROL OVER PLANS:

Participants invested money in 401 (k) benefit plans. They brought suit on behalf of themselves and a putative class of benefit plans and plan participants that have held or continue to hold group annuity contracts with John Hancock Life Insurance Company. They allege that John Hancock charged excessive fees for its services, in breach of its fiduciary duty under the Employee Retirement Income Security Act of 1974. The District Court granted John Hancock's motion to dismiss, ruling that John Hancock was not a fiduciary with respect to the alleged breaches. The Court of Appeals affirmed. To be a fiduciary within the meaning of ERISA, a person must act in capacity of manager, administrator or financial advisor to a plan. This so-called functional fiduciary duty is contextual -- it arises only to the extent a person acts in an administrative, managerial, or advisory capacity to an employee benefits plan. Because an entity is only a fiduciary to the extent it possesses authority or discretionary control over the plan, the

Court must ask whether the entity is a fiduciary with respect to the particular activity in question. Thus, the threshold question is not whether the actions of some person employed to provide services under a plan adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary when taking the action subject to complaint. Participants identified three actions that purportedly made John Hancock the fiduciary: they alleged that John Hancock was a fiduciary because it selected investment options; because it monitored performance of the funds; and because under the terms of its contracts had authority to add, remove or substitute investment options it offered and to alter the fees it charged for its services. All three arguments failed. The Court must defer to the Department of Labor's reasonable interpretation of ambiguous provisions of ERISA. The Department's regulation is valid, and under it, participants have failed to plead that John Hancock was an investment advice fiduciary. *Santomenno v. John Hancock Life Insurance Company*, Case No. 13-3467 (U.S. 3rd Cir. September 26, 2014).

2. SOCIAL SECURITY COLAs SLATED TO INCREASE SLIGHTLY IN 2015: InvestmentNews says that Social Security benefits are likely to increase by 1.7% in 2015, slightly more than this year's 1.5% increase but still well below average increases over the past few decades. The figure comes from an unofficial projection by the Senior Citizens League. Based on the latest consumer price index data through August, the advocacy group's projection of a 1.7% increase in Social Security benefits for 2015 would make the sixth consecutive year of record low COLAs, unprecedented since the COLA first became automatic in 1975. Inflation over the past five years has been growing so slowly that the annual increase has averaged only 1.4% per year since 2010, less than half of the 3% average during the prior decade. In 2010 and 2011, benefits did not increase at all, following a 5.8% hike in 2009. Although the annual adjustment is provided to protect buying power of Social Security payments, beneficiaries report a big disparity between benefit increases they receive and increase in costs. The majority of Social Security recipients said that their benefits rose by less than \$19 in 2014, yet their monthly expenses rose by more than \$119. Social Security beneficiaries have lost nearly one-third of their buying power since 2000. Low COLAs affect not only people currently receiving benefits, but also those who have turned 60

and who have not yet filed a claim. The COLA is part of the formula used to determine initial benefits and can mean a somewhat lower initial retirement benefit. A 1.7% increase would increase average Social Security benefits by about \$20 next year, and boost the maximum amount of wages subject to payroll taxes by nearly \$2,000 above this year's \$117,000 level.

3. STOCKTON BANKRUPTCY RULING MAY LEAD TO PENSION

CUTS: A federal judge's recent verbal ruling that Stockton's payments to California Public Employees' Retirement System may be impaired is consistent with Fitch's view of pension liabilities in bankruptcy of a municipality. Payments to pensions may be protected by anti-impairment language in state law, but in a federal bankruptcy proceeding they are at risk for impairment like any other liability. The ability to impair otherwise protected obligations to reset a debtor's financial profile is a key premise of municipal bankruptcy law. Bankruptcy protection provided to special revenue obligations and preservation of statutory liens under the federal law are not affected by this outcome. If established as a precedent, the Stockton ruling may increase incentives for distressed municipalities to seek pension cuts in bankruptcy court. However, Fitch believes those seeking bankruptcy protection will do so whether or not they can be certain of their ability to impair pensions. More likely, the ruling may encourage labor and management to negotiate pension cuts to avoid uncertainties of bankruptcy court. The ruling for Stockton's employees may be minimal, as the city has proposed no pension benefit reductions for CalPERS members. Local officials contend that previously enacted reductions to employee and retiree health benefits have already been substantial, and that further retirement benefit cuts would hurt Stockton's ability to attract and retain employees. In contrast, Detroit has proposed to reduce benefit payments to pension system members, although to a lesser extent than for general government debt holders. The Stockton ruling might raise the bar for bankruptcy plan confirmation, as the court must determine it is fair and equitable without pension impairment, despite other creditor objection. The Stockton ruling follows several attempts by well-functioning California municipalities with large long-term liabilities to reduce pension costs. Efforts to impose pension cuts through voter initiatives in San Jose and San Diego have been delayed by litigation of such reductions outside of bankruptcy under California and other

state constitutions remains unclear. Separately, *Investor's Business Daily* reports that CalPERS maintains that a municipality's pension obligations are guaranteed under the state constitution, and may never be reduced. While the judge's remarks were informal and do not bind the court or set precedent in any way, they still constitute a public policy ruling on a substantial order of magnitude. Under bankruptcy law, a debtor must propose rejecting a contract, and all a judge can do is approve or reject that proposal. The giant retirement system has fought vociferously to keep municipalities, even those declared insolvent, from cutting pension liabilities at all, even as other creditors and budget lines sustain heavy cuts. But as evidence mounts that such an approach leaves cities struggling, so has criticism of it.

4. NEW HAMPSHIRE RETIREMENT SYSTEM AMENDMENT NOT UNCONSTITUTIONAL RETROSPECTIVE LAW: Anderson appealed an order of the Superior Court of New Hampshire, granting summary judgment to the New Jersey Retirement System, denying summary judgment to Anderson. On appeal Anderson argued that the trial court erred when it determined that the retirement statute as applied to him was not an unconstitutional retrospective law. Anderson was a retired Plaistow police officer, who was a member of the New Hampshire Retirement System. He retired in November of 2011, and thereafter worked part-time as a police officer in Plaistow, Atkinson and Hampstead. When he retired, the statute provided that part-time for the purposes of employing a NHRS retiree meant, employment by an NHRS employer of no more than 32 hours in a normal calendar week, or if the work hours in some weeks exceeded thirty-two hours, then no more than 1,300 hours in a calendar year. Anderson understood that provision to mean he could work potentially up to 32 hours per week for Plaistow, up to 32 hours per week for Atkinson and up to 32 hours per week for Hampstead. In 2012, the legislature amended the statute to provide that part-time for the purposes of employing a NHRS employee meant employment during a calendar year by one or more employers of the retired member, which shall not exceed 32 hours in each normal calendar week or if the work hours in some weeks exceed thirty two hours, then no more than 1,300 hours in a calendar year. In Anderson's suit for declaratory and injunctive relief, he contended that to apply the 2012 amendment to him violated the New Hampshire Constitution because as a result of the 2012 amendment, he would be "restored to service," and, thus, lose his retirement

benefits if he worked more than part-time as defined by the amendment. When a retiree is "restored to service," his retirement allowance shall cease, and he shall again become a member of NHRS and shall contribute to the system. The Supreme Court of New Hampshire did not reach the merits of Anderson's constitutional challenge to the 2012 amendment because it concluded that it rested upon a mistaken interpretation of the underlying statutes. The legislature has provided that in construing all statutes, words importing the singular number may extend and be applied to several persons or things, unless such construction would be inconsistent with the manifest intent of the legislature or repugnant to the context of the same statute. In the instant case, the 2012 amendment made clear that such construction was consistent with legislative intent. When the legislature changed "an employer" to "one or more employers" in 2012, it stated that it was merely clarifying recent changes to the administration of NHRS. In other words, although the pre-2012 version of the statute referred to "an employer," the legislature intended the singular "an employer" to include the plural "one or more employers." Thus, contrary to Anderson's contentions on appeal, when he retired in 2011, he had no right, vested or otherwise, to work up to thirty-two hours per week or 1,300 hours per year for more than one NHRS employer. Because the court resolved Anderson's appeal in this way, it expressed no opinion as to whether he correctly interpreted the applicable statutes when he contended that a NHRS employee is restored to service pursuant to statute when he works more than part-time as defined, but fewer than the full-time hours required for membership in the NHRS. The court invited the legislature to clarify its intent. Talking about dodging an issue. *Anderson v. Executive Director, New Hampshire Retirement System*, Case No. 2013-620 (NH September 30, 2014).

5. REASONS WHY YOU SHOULD NOT BORROW FROM YOUR 401(k) PLAN: When you need cash -- not the 50 bucks you get from an ATM to tide you over for the day, but, rather, \$5,000 or \$10,000 to handle an emergency -- what asset or resource will you tap into to get it? Historically, the answer to that question was a home equity loan, according to CNBC. Unfortunately, retirement accounts have replaced the home equity loan as a predominant source of cash today. They have become America's new piggy bank. IRS collected \$5.7 billion in penalties in 2011 for early withdrawals from 401(k) plans and other

retirement accounts. Generally, the penalty for withdrawing before age 59½ is 10%, meaning that Americans withdrew \$57 billion from their retirement savings before they were supposed to. Borrowing from your retirement account for any reason, no matter how serious that reason may seem to you, will hurt you in the long run. It is a sure way to destroy your retirement savings and put you at risk of having a lot less money than you had planned for in your golden years. Here are Jim Cramer's top ten reasons why you should never, ever borrow from your 401(k) plan:

- **Borrowing defeats the very purpose of the account.** The money is there for one reason only: to provide for your retirement. No matter how urgent you think your present situation is, it will be nothing compared to what you will experience when you are in your 70s or 80s without adequate funds.
- **The magic of compounding will be lost.** Pulling money from your 401(k) means that you are selling some of your investments. If they continue to rise in value, you will not get the profits and the compounding power that goes with them.
- **You are likely to sell low and buy high.** As you pay back the "loan," you are rebuying the previously sold shares, but at current (and probably higher) prices.
- **You will be charged added interest and fees.** Most plans charge an origination fee regardless of loan size, which goes to the administrator, not back into your account. Thus, if you borrow \$1,000, with a \$100 origination fee, you have lost 10% right away. While the interest you pay, which is based on prevailing rates (about 5%), goes back into your account, that is money you otherwise could have invested for potentially higher returns.
- **Contributions could be suspended.** Many plans will not allow you to contribute to your 401(k) until you have paid off your loans.
- **Your take home pay will be reduced.** Most plans require you to start repaying your loan via automatic paycheck deduction. Thus, your take home pay is reduced, possibly by more than the amount you were contributing to the plan before. And this repayment is not tax-deferred, so your taxes could rise, lowering your net pay even further.
- **Failure to repay by the deadline will trigger a tax risk.** Most

401(k) plan loans must be repaid within five years. If you fail in that, your employer will treat the loan balance as a distribution, triggering income taxes and the 10% early withdrawal penalty if you are under age 59½.

- **There is additional risk if you quit or lose your job.** If you leave your employer, the loan will be due within 90 days. But wait, you have already spent the money. If you do not meet the deadline, IRS will consider the unpaid balance to be taxable income, and you will face the same tax issues previously noted.
- **You will incur double taxation.** Loans from your 401(k) actually cause you to pay taxes twice. Why? Because you are repaying with after-tax money and then later, when you withdraw the funds in retirement, you will pay taxes on that same money again. (Such a deal.)
- **You will still be in debt.** If you borrow from retirement savings to pay off other debts, you have simply exchanged one debt for another --and taken on all the above disadvantages in the process. A recent study found that borrowing \$10,000 from a retirement plan will reduce your account balance in retirement by \$100,000!

A recent Fidelity study pointed to yet another danger: it found that, of 180,000 who took out 401(k) loans over the past 12 years, 66% took out more than one loan, 25% borrowed 3 or 4 times and 20% did so five times or more. Thus, initial borrowing could put you in danger of becoming a repeated borrower, thereby causing you greater damage to your retirement savings.

6. TEXAS "UPSKIRTING" STATUTE INVALID: In Texas, an 'improper photography or visual recording' statute makes it a crime, among other things, to photograph or record by electronic means a visual image of another person under certain circumstances. Subsection (b)(1) of the statute makes such acts a crime if: (1) the person being photographed or recorded is not in a bathroom or private dressing room, (2) the photograph or recording of the person is made without that person's consent and (3) the photograph or recording is made with the intent to arouse or gratify the sexual desire of any person. (See C & C Newsletter for April 3, 2014, Item 7). The Texas Court of Criminal Appeals held that, to the extent it proscribes taking photographs and recording visual images, subsection (b)(1) of

the statute is facially unconstitutional in violation of the freedom of speech guarantee of the First Amendment. Consequently, the (court affirmed the judgment of the Court of Appeals. Thompson was charged with twenty-six counts of improper photography or visual recording under Texas Penal Code § 21.15(b)(1). Each count of the indictment alleges that Thompson, "with intent to arouse or gratify the sexual desire of himself, did by electronic means record another at a location that was not a bathroom or private dressing room." Each count further specified the name of an file that was recorded. Some of the counts contain additional information regarding the subject matter and location of the recording. For instance, several counts describe "unknown females" with various colors of bathing suits or bikinis in or at a water park. Thompson filed a pretrial application for a writ of habeas corpus, in which he alleged that the statute on which his prosecution was based is facially unconstitutional in violation of the First Amendment. The trial court denied the application, and Thompson appealed and the Fourth Court of Appeals held the statute void on its face in violation of the First Amendment. The intermediate appellate court analyzed the issue in three parts: (1) whether the First Amendment was implicated by the statute, (2) whether the statute was content based or content neutral and (3) whether the statute satisfied intermediate scrutiny. First, the court concluded that the First Amendment was implicated because the statute not only restricts an individual's right to photograph, a form of speech protected by the First Amendment, but the statute also restricts a person's thoughts, which the U.S. Supreme Court has held is wholly inconsistent with the philosophy of the First Amendment. Second, the court concluded that the statute was content neutral because it does not favor one type of photograph over another. Finally, the court concluded that the intermediate scrutiny standard was not satisfied because the statute reached a substantial amount of constitutionally protected conduct. As a consequence of its holding, the Court of Appeals reversed the judgment of the trial court, and remanded the case for entry of an order dismissing the prosecution. (Note that the opinion is 9 pages long, with 158 foot notes.) *Ex Parte Thompson*, Case No. PD-1371-13 (Tex. Crim. App. September 17, 2014).

7. INCOME AND POVERTY IN THE UNITED STATES: The Department of Congress, Census Bureau, has released a current population report entitled "Income and Poverty in the United States:

2013." The report presents data on income and poverty in the United States based on information collected in 2014 and earlier Current Population Survey Annual Social and Economic Supplements conducted by the U.S. Census Bureau. Here is a short summary of findings:

- Real median household income in 2013 was not statistically different from the 2012 median income.
- The official poverty rate decreased between 2012 and 2013, while the number in poverty in 2013 was not statistically different from 2012.

For most groups, the 2013 income estimates were not statistically different from 2012 estimates. There were a few exceptions. Real median household income increased for Hispanic households, households maintained by a noncitizen, and households maintained by a householder aged 15 to 24 or aged 65 and older. The 2013 poverty rates decreased for all people and for these groups: Hispanics, males and females, children under age 18, the foreign born, people outside metropolitan statistical areas, all families, and married couple families. P60-249 (September 2014).

8. WANNA SEE IT AGAIN?: At a recent pension board meeting, a well-respected Florida money manager made what seemed to us to be a preposterous statement about the average holding period for a stock. Normally, we would take this person's word for granted, but we openly questioned the particular statement as seeming unsupportable:

...turnover was having a real-world impact on stocks. At the end of World War II, the average holding period for a stock was 4 years. By 2000, it was eight months. For 2008, it was two months. And by 2011 it was twenty-two seconds, at least according to one professor's estimates.

Low and behold, a few days later, we received in the mail a copy of *Dark Pools*, best-selling author Scott Patterson's new book on the rise of machine traders. On page 46, the money manager's statement was a direct quote.

9. STUFF YOU DID NOT KNOW: The cost of raising a medium-size dog to the age of eleven: \$ 16,400.

10. TODAY IN HISTORY: In 1946, October 9th apparently was a day of contrasts: the first electric blanket was manufactured (and sold for \$39.50) and Eugene O'Neill's "The Iceman Cometh" premiered in New York City.

11. KEEP THOSE CARDS AND LETTERS COMING: Several readers regularly supply us with suggestions or tips for newsletter items. Please feel free to send us or point us to matters you think would be of interest to our readers. Subject to editorial discretion, we may print them. Rest assured that we will not publish any names as referring sources.

12. PLEASE SHARE OUR NEWSLETTER: Our newsletter readership is not limited to the number of people who choose to enter a free subscription. Many pension board administrators provide hard copies in their meeting agenda. Other administrators forward the newsletter electronically to trustees. In any event, please tell those you feel may be interested that they can subscribe to their own free copy of the newsletter at <http://www.cypen.com/subscribe.htm>.

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