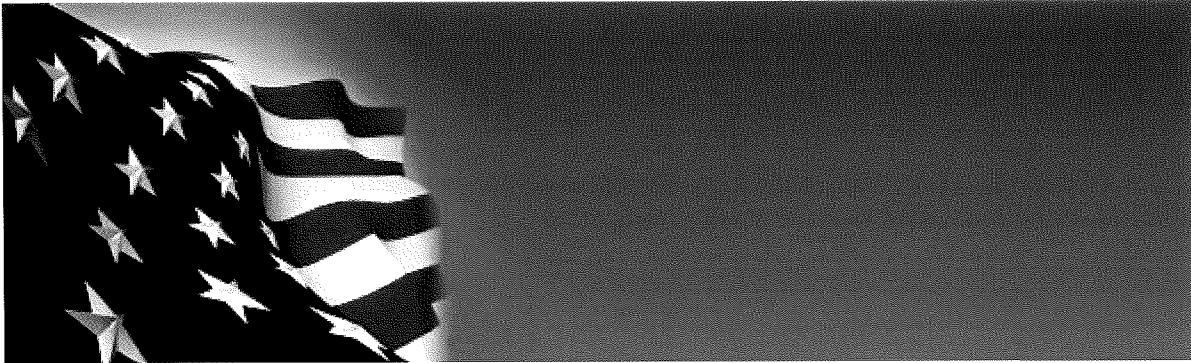


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CYPEN & CYPEN NEWSLETTER for JANUARY 22, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. BIG MUNICIPAL BANKRUPTCIES -- WHY SO MANY?:

Onwallstreet.com says that 2015 may be midpoint in what could turn out to be the decade of municipal bond bankruptcy. Four of the five largest municipal bankruptcy filings in United States have been made in the last three years, a trend analysts attribute to aftereffects of the 2008 credit crisis and Great Recession, as well as changing attitudes about debt. The crash of 2008 and five years of stagnation preceded by years of escalating wages, pensions and other post-employment benefits set the stage for the recent Chapter 9 filings. Chapter 9 municipal bankruptcy was adopted in 1937, but had been rarely used, particularly by large governments. However, since November 2011 San Bernardino, California, Stockton, California, Jefferson County, Alabama and Detroit have filed four of the five largest bankruptcies as measured by total obligations. Orange County, California's, 1994 filing ranks third, behind Detroit and Jefferson County. Last year had the largest par value of defaults in any year since 2009. Experts agree the

depth of the Great Recession was a main cause of the latest round of big bankruptcies. When the broader economy started to pick up, recovery never came to these municipalities, leaving revenues depressed. Though none of the big bankruptcies took place while the U.S. economy was shrinking, the recession triggered other events that contributed to the need to file for protection. The recession and credit crisis put governments that were overexposed to debt and liabilities on one of two roads to bankruptcy: in one, municipalities that were dependent on continued rapid growth found themselves saddled with obligations they could no longer meet. On the other road, some municipalities that had already been in long term structural decline before recession, found themselves with little backing.

2. COMPARING VARIOUS MEASURES OF PENSION LIABILITIES:

Different values are placed on liabilities of defined benefit pension plans in different contexts according to a note on russell.com. But how do these values relate to one another? Although different values are placed on liabilities in different contexts they are all related to one another to some extent. In the note, the author compares: economic value (EV); projected benefit obligation (PBO); accrued benefit obligation (ABO); funding target liability (FTL); annuity buyout or "pension risk transfer" cost (PRT); total economic cost (T); and hibernation cost (H). Here is a brief explanation of each valuation:

- **Economic value.** A pension is a series of payments promised to a retiree. Placing a value on a promise of this nature is a basic activity in both accounting and actuarial practice. One begins by defining an "economic value", which following that standard practice, is the value that the open market would place on the projected cash flows promised by the pension plan. Projections of future benefit amounts may either include or exclude impact of participants' future salary increases, depending on the purpose for which the calculation is being made. This value is the starting point, although none of the liability values to be considered is exactly equal to it.
- **Projected benefit obligation.** Since the 2006 publication of Statement of Financial Accounting Standards 158 (now incorporated in FASB Accounting Standards Codification 715), the PBO shown in the balance sheet of U.S. corporations has been conceptually close to the economic value, as described

above. The main difference in calculations performed up to date has been in mortality assumptions; but recently, most corporations have used mortality tables that were published by the Society of Actuaries almost 15 years ago. These tables do not reflect the increase in life expectancy that has occurred since then. As a result, PBO has typically been around 5% to 7% below what it should be based on the most up-to-date mortality assumptions. The SOA published updated tables in 2014. The signs are that most corporations will adopt the new mortality tables either in their 2014 or 2015 financial statements. This exercise will cause an increase in PBO, bringing it close to economic value.

- **Accrued benefit obligation.** ABO is similar to PBO, except that it does not include allowance for the effect of future salary increases. In case of a frozen pension plan, benefits are no longer tied to future final salary, so ABO equals PBO. ABO also equals PBO for other plan types that do not link benefits to final salary, such as cash balance plans or flat dollar benefit plans.
- **Funding target liability.** Unlike the other measures described in the note, the link between FTL and economic value is quite tenuous, mainly because FTL most commonly uses a discount rate that is not linked to current bond prices, but rather to a 25-year average. This link is the result of recently enacted legislation -- the Moving Ahead for Progress in the 21st Century Act of 2011 (MAP-21) and the Highway and Transportation Funding Act of 2014 (HATFA) -- that was intended to reduce corporate pension contributions and hence increase federal tax revenue.
- **Annuity buyout cost.** Annuity buyout cost is the sum required by an insurance company for a full pension risk transfer (PRT). This cost is determined by the insurance company, and varies depending on market conditions. However, it tends to be fairly closely linked to economic value, since risk transfer involves the insurance company's taking on responsibility for payment of the promised benefits. Therefore, the quoted price will reflect the expected cost of making those payments, with some margin for defaults or downgrades in the fixed income securities held and for insurance company expenses and profit.

- **Total economic cost.** Although the cost of transferring the pension liability to an insurance company will nearly always exceed economic value, so will cost of retaining that liability. Sponsor faces the same risk of default or downgrade in investment securities as the insurance company does. In addition, there are administrative costs involved in running the plan, as well as premiums payable to PBGC. For this reason, marketing materials and illustrations of annuity prices tend to compare the annuity buyout cost (PRT) to the total economic cost to the corporation (T) of retaining the plan.
- **Hibernation cost.** Hibernation involves a plan sponsor's retaining a frozen plan for a period, with an annuity buyout following at a yet-to-be-determined date. Because of the optionality around timing, precise calculation of the cost of hibernation can be difficult. However, since the sponsor has control over the timing of a buyout, hibernation should always be less than total economic cost (T) of retaining the plan indefinitely.

Now aren't you glad you learned something useful today?

3. OVER TWENTY PERCENT OF INVESTORS HAVE TAPPED INTO 401(k) PREMATURELY: The majority of non-retired investors in the U.S. say their employer offers a 401(k) plan, and of these, 89% say they participate in it. Yet, 21% of those who participate in such a plan say they have either taken out a 401(k) loan or even taken an early withdrawal from the plan in the last five years, according to gallup.com. However, only 5% have lowered or stopped contributing to the plan.

4. MIAMI AND ORLANDO AMONG MOST EXPENSIVE CITIES FOR RENTERS: San Jose, California, is the city where rent was most expensive in 2014, according to Zillow as reported by southflorida.citybizlist.com. The average monthly rent in San Jose was \$1,807. The study by the real estate website found that U.S. renters spent a combined \$441 billion on housing in 2014. To find out who spent the most in 2014, Zillow looked at the 50 largest metros in the U.S., and compared the average amount renters paid per month. Here are some of the top metros:

- Washington, D.C. average monthly rent: \$1,428

- New York, N.Y./Northern N.J. average monthly rent \$1,228
- Boston, MA average monthly rent: \$1,197
- Miami/Ft. Lauderdale, FL average monthly rent: \$1,127
- Baltimore, MD average monthly rent: \$1,047
- Austin, TX average monthly rent: \$1,008
- Orlando, FL average monthly rent: \$931

5. CRAZIEST BUSINESS EXPENSES OF THE YEAR: Expense management software company Certify asked 60,000 business travelers about their expense spending for 2014. Here are the top 10 most unconventional business expenses that were submitted last year:

- Mattress Pad (Cost: \$25.00)
- Cher concert tickets (Cost: \$125)
- Hyperbaric oxygen chamber (Cost: \$4,757)
- Christmas tree pajamas (Cost: \$40)
- Book on motivation (Cost: \$25)
- One-year-old shipping charge (Cost: \$25)
- Sleeping pills (Cost: \$10)
- Freezer and microwave oven (Cost: \$700)
- Hail damage to vehicle (Cost: \$500)
- Scuba diving trip (Cost: \$700)

Note that all the subject expenses were approved, and paid or reimbursed.

6. DILLERISMS: Best way to get rid of kitchen odors: Eat out. Phyllis Diller

7. YOU KNOW YOU ARE LIVING IN 2015 when...: You accidentally enter your PIN on the microwave.

8. TODAY IN HISTORY: In 1973, George Foreman TKOs Joe Frazier in 2 for heavyweight boxing title.

9. 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.

10. 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>.

11. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.

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