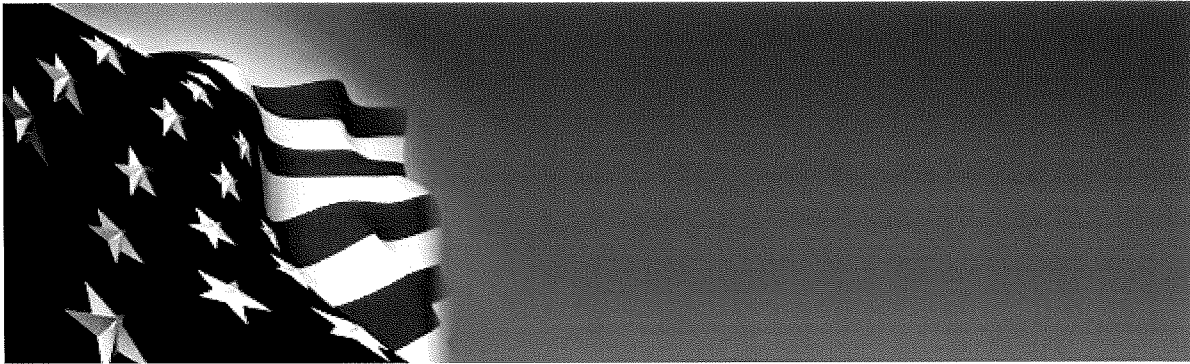


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CYPEN & CYPEN NEWSLETTER for FEBRUARY 26, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. HOW MUCH WILL PRIVATE SECTOR EMPLOYER DB CONTRIBUTIONS RISE, AND WHEN?: In October 2011, the Society of Actuaries published an outlook on future contribution requirements for the private sector single-employer defined benefit system. The analysis showed that, under specific assumptions about future plan experience, the amount of cash contributions required of plan sponsors participating in the system would increase over the coming decade. Since the 2011 projection, plan sponsors contributed more than four times the required amount, the Federal law governing required contributions changed twice and financial markets performed better than expected through the beginning of 2014. A new brief updates projection of future contribution requirements to take into account more recent plan experience and a more current view of future economic experience. SOA also tests economic sensitivity of its results by analyzing three alternate economic scenarios. For this analysis, SOA based assumptions about future capital market

changes on explicit macroeconomic scenarios produced by Moody's Analytics. All future scenarios were calibrated to an economic outlook as of June 30, 2014. The analysis shows that:

- Despite excess contributions by plan sponsors and market experience that outperformed expectations, the single-employer defined benefit system still faces increases in future funding requirements.
- While Moody's places an even chance on economic performance above or below its baseline projection, underperformance can be much more consequential for short-term funding of the DB system than outperformance, based on a July 2014 view of the business cycle.
- Rising interest rates alone will not resolve future increases in funding requirements.

Note that interest rate declines since June 2014 have reduced measures of plan funding relative to baseline scenarios. Therefore, a current projection would show slightly higher contribution requirements over the next decade.

2. MEASURING OUR RETIREMENT DEFICIT: How big is the retirement savings gap that most Americans are likely to face? New research from the nonpartisan Employee Benefit Research Institute indicates it varies widely by gender, marital status and other factors, but the aggregate national retirement savings deficit is about \$4.13 trillion for all U.S. households between the ages 25 and 64. However, that estimate is based on current Social Security benefits not being cut in the future. With the program's Old-Age, Survivors and Disability Insurance trust fund projected to be exhausted by 2033, EBRI estimates the retirement deficit will increase to \$4.38 trillion at that time if no additional funding is provided and a pro rata reduction in Social Security benefits is allowed to take effect. To illustrate just how important Social Security is to Americans' ability to afford retirement, EBRI also estimates that if the program were to be eliminated this year, the aggregate national retirement deficit would increase by nearly 90%, to \$7.87 trillion. The new analysis is based on results from EBRI's proprietary Retirement Savings Projection Model, and estimates the size of deficits that households are simulated to

generate in retirement, or retirement savings shortfalls. It follows an earlier simulation modeling of last year detailing the probability of households likely to not run short of money in retirement. Other study findings are

- The retirement savings shortfalls show that for those on the verge of retirement (Early Baby Boomers), the deficits vary from \$19,304 (per individual) for married households, increasing to \$33,778 for single males and \$62,734 for single females.
- While these RSS values may appear to be relatively small considering they represent the sum of present values that may include decades of deficits, it is important to remember that less than half of the simulated life paths modeled are considered to be “at risk.” Looking only at those situations where shortfalls are projected shows that the values for Early Boomers vary from \$71,299 (per individual) for married households, increasing to \$93,576 for single males and \$104,821 for single females.
- RSS values are much smaller for Gen Xers with significant years of future eligibility for defined contribution plan participation. The deficit values for Gen Xers assumed to have no future years of eligibility (as if they were never simulated to be employed in the future by an organization that provides access to those plans) is \$78,297 per individual. That shortfall decreases substantially (to \$52,113) for those with one to nine years of future eligibility, and even further to \$32,937 for those with 10–19 years of future eligibility. Gen Xers fortunate enough to have at least 20 years of future eligibility in those programs could find their average shortfall at retirement reduced to only \$16,782.

3. EMPLOYEE CONTRIBUTIONS TO PUBLIC PENSION PLANS: A new issue brief from National Association of State Retirement Administrators reminds us that for the vast majority of employees of state and local government, both participation in a public pension plan and contributing toward the cost of the pension are mandatory terms of employment. Requiring employees to contribute distributes some of the risk of the plan between employers and employees. The primary types of risk in a pension plan pertain to investment, longevity and inflation. Employees who are required to contribute toward cost of their pension assume a portion of one or more of these risks,

depending on plan design. The prevailing model for employees to contribute to their pension plan is for state and local governments to collect contributions as a deduction from employee pay. This amount usually is established as a percentage of the employee's salary and is collected each pay period. Employee contribution rates typically are between four-and eight percent of pay, but are outside these levels for some plans. In some cases, required employee contributions are subject to change depending on condition of the plan and other factors. In some plans, employee contributions are actually paid by the employer in lieu of a negotiated salary increase or other fiscal offset. As much as 30% of employees of state and local government do not participate in Social Security. In most cases, the pension benefit -- and required contribution -- for those outside of Social Security is greater both than the typical benefit and the required contribution for those who do participate in Social Security. Many states in recent years have made changes requiring employees to contribute more toward their retirement benefits: since 2009, more than 35 states (including Puerto Rico) have increased required employee contribution rates. Some states (like Florida and Missouri) that previously did not require some employees to make pension contributions have added required contributions for newly hired employees, existing workers, or both. Pennsylvania recently joined other states (like Arizona, Iowa, Kansas and Nevada) in maintaining an employee contribution rate that varies depending on the pension plan's actuarial condition. Because of the effect investment returns have on a pension plan's actuarial condition, employee contributions generally will rise following periods of sub-par investment returns and fall when investment returns exceed expectations. Changes approved in California require many workers to pay one-half of the normal cost of the benefit, which can result in a variable contribution rate. And the Utah plan affecting new hires requires employees to contribute the full cost of the benefit above 10% of pay. States like New Mexico and Wyoming have increased employee contributions for all workers -- current and future. In some cases, such as Virginia and Wisconsin, new and existing employees, in lieu of a salary increase, are now required to pay contributions that previously were made by employers. Another way employees are paying more is through the establishment of hybrid plans, which transfer risk from employer to the employee. For example, in 2012 Kansas created a new cash balance plan (effective January 1, 2015) and Tennessee in 2013 created a new

combination defined benefit-defined contribution plan, for newly hired workers in both cases. Some employees in other states, including Georgia, Indiana, Nebraska, Oregon, Texas and Virginia already participate in hybrid plans, which distribute a greater share of risk to the employee. Employee contributions in some cases are set by collective bargaining, and can be changed when labor agreements are negotiated. For example, required employee contribution rates for many employee groups in California have increased in recent years as a result of labor agreements. Legality of increasing contributions for current plan participants varies. Some states prohibit an increase in contributions for existing plan participants. A 2012 ruling in Arizona found that legislative efforts to increase contributions on existing workers are a violation of the state constitution. In other states, however, higher employee contributions either have not produced a legal challenge (like in Minnesota and Mississippi) or have withstood legal challenges (like New Hampshire and New Mexico). The conclusion is that employee contributions are a key component of public pension funding policies. The vast majority of employees of state and local government are required to contribute to the cost of their pension benefit, and the number has grown in recent years as most states that previously administered non-contributory plans now require worker contributions. Many employees also are being required to contribute more toward cost of their retirement benefit. In some cases, this requirement applies to both current and new workers; in other cases, only to new hires. A growing number of states is exposing employee contributions to risk, either by tying the rate directly to the plan's investment return, or by requiring hybrid or 40(k)-type plans as a larger component of the cost of the employee's benefit. Some of these changes to contribution requirements affecting existing plan participants are currently under legal review. The outcome of these legal challenges is likely to affect additional future reforms in this area.

4. JERSEYS GOVERNOR'S PENSION CUTS UNCONSTITUTIONAL: A New Jersey judge has ruled that Governor Christie violated public sector unions' contractual rights when he cut the state's payment to the pension system for public workers. According to *Governing*, the Judge ordered the Governor to work with the Legislature to find a solution. The governor has indicated he will appeal. Christie slashed the state's payment to the \$80 billion pension

system from \$2.25 billion to \$681 million as part of the state's annual appropriations act. The Democrat-controlled Legislature had passed a budget that funded the payment by raising taxes on New Jersey's highest earners and businesses. Christie vetoed the tax. The public sector unions sued, alleging that Christie had violated a 2011 law that established a contractual right to bigger pension payments (See C & C Newsletter for June 12, 2014, Item 2). The law was implemented after years of skipped payments by governors of both parties, and was meant to shore up the underfunded pension system, which now has an unfunded liability between \$37 billion and \$82 billion, depending on the accounting method used to calculate it. A copy of the complete 130-page opinion of the court can be found at http://www.judiciary.state.nj.us/pension_payment/FINAL%20decision%202-23-2015.pdf. *Burgos v. State of New Jersey*, Docket No. MER-L-1267-14, (Sup. Ct. N.J., February 23, 2015).

5. COMPANIES' BALANCE SHEETS WILL REFLECT HIGHER COST OF LONGER LIVES: When, according to *The Wall Street Journal*, General Motors Co.'s pension plan took a big hit, it joined hundreds of companies facing growing pension shortfalls as Americans keep living longer. Longevity has a downside for those paying the bills, and the higher costs now have to be reflected on corporate balance sheets because of new mortality estimates. In its first revision of mortality assumptions since 2000, the Society of Actuaries estimated the average 65-year-old man today will live 86.6 years, up from the 84.6 it estimated a decade and a-half-ago. The average 65-year-old woman will live 88.8 years, up from 86.4. The new estimates will not affect many U.S. companies, which long ago shifted their employees to defined contribution plans like 401(k)s, which leave workers on their own after retirement. But they are hitting other big companies with defined benefit plans that have to make payments to some former employees for as long as they live. (Gee, what a shame.) The changes may also prompt more companies to take steps to reduce the risks associated with their pension plans. Note, as we understand it, governmental pension plans are not necessarily required to change to the new mortality assumption table.

6. PENSION INVESTMENTS BLOW AWAY GDP: Pension investments in stocks, bonds, cash and alternative assets such as real estate have surged relative to the country's growth domestic

product over the last decade, according to a Towers Watson & Co. report published in *The Wall Street Journal*. In fact, the value of U.S. pension assets jumped over 89%, while GDP rose roughly 42%. Those investments were worth an estimated \$22.1 trillion last year, 127% of the country's \$17.4 trillion gross domestic product. This percentage is the highest on record, up nearly 32 percentage points from a decade earlier. Assets in defined contribution plans like 401(k)s, under which employees are largely responsible for their retirement savings, exceed those in defined benefit plans, which are financed by employers and promise a set payout. Last year, defined contribution assets made up 58% of all pension assets. That transfer of risk could present a problem for less market minded employees. U.S. pension investments accounted for more than 61% of the \$36.1 trillion global total. That total is 84% of global GDP. Global pension assets relative to global GDP are up roughly 15 percentage points from the decade earlier.

7. SUCCESS STRATEGIES FOR WELL-FUNDED PENSION PLANS: Center for State & Local Government Excellence conducted case studies to examine the public pension systems in four states with the long tradition of being well-funded, to determine what successful practices they have in common. The plans studied were Delaware Public Employees' Retirement System, Illinois Municipal Retirement Fund, Iowa Public Employees' Retirement System, and North Carolina Retirement Systems. While each of the defined benefit plans has unique history and legal framework, they share these practices:

- A commitment to fund the annual required contribution in both good and bad financial times;
- Conservative, realistic assumptions that are adjusted based on experience; and
- Changes to benefit levels and contribution rates as needed.

The funded ratio for the plans studied range from 87.6% to 99.8%. SLG15-01 (02/15).

8. REASONS STATE HOUSE SPEAKERS ARE PRONE TO CORRUPTION: *Governing* says politicians holding any kind of office can get themselves into legal trouble. Lately, though, state House speakers have been especially prone to indictment. Facing federal corruption charges, Democrat Sheldon Silver of New York agreed to

relinquish his duties as Assembly speaker. Silver, who is accused of accepting bribes in form of legal fees, is the fourth speaker to enter into legal peril over the past 10 months: Bobby Harrell in South Carolina, Gordon Fox in Rhode Island and Mike Hubbard in Alabama (re-elected despite outstanding indictment). Each case is different, but all concern allegations of corruption or ethical abuses. This cluster of indictments opens up the question of whether there is something in the nature of the job of speaker that makes corruption more likely to occur. Here are five potential explanations as to why some speakers may find themselves in hot water:

- **Lots of Power.** Speakers are powerful figures, often able to control their chambers in a hierarchical way not available to many other political leaders. Speakers can kill a bill quietly, simply by assigning legislation to hostile committees. Governors may need to issue veto messages, but speakers can do much of their work secretly.
- **...But Not Much Scrutiny.** Speakers may be powerful, but they receive comparatively little media attention. Most people can name their state's governor, but few people know who the speaker is.
- **Limited Political Pressure.** Speakers not only receive less media attention than governors, they also answer to fewer voters than any comparably powerful politician. They might represent districts that account for a hundredth share of their state's population. They are elected locally, but their impact is statewide. Not only are their districts small and generally safe, but often the majorities they lead are safe as well.
- **Tendency to Play Let's Make a Deal.** Speakers are able to direct enormous sums of money. In an era where caucus leadership PACs can dominate legislative campaign fundraising, they need enormous sums of money. Speakers have enormous power and the duty to raise large amounts of political money.
- **Tempting Targets for Prosecutors.** Making public corruption cases is always tough for prosecutors -- there generally is not tangible evidence like drugs waiting to be seized, -- but elected officials still make tempting targets for ambitious prosecutors, particularly those as prominent as a state House speaker. There has been no shortage of legislators in New York who have faced indictment in recent years, but the power and prestige Silver held

as the longtime speaker made him stand out. (New York can count 32 scandals involving legislators and state officials over the past 7 years.)

9. DILLERISMS: You know you're old if they have discontinued your blood type. Phyllis Diller

10. YOU KNOW YOU ARE LIVING IN 2015 when...: You e-mail the person who works at the desk next to you.

11. TODAY IN HISTORY: In 1954, Michigan rep Ruth Thompson (R) introduces legislation to ban mailing "obscene, lewd, lascivious or filthy" phonograph (rock & roll) records.

12. 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.

13. 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>.

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

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