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# CYPEN & CYPEN NEWSLETTER for MARCH 12, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

**1. SYSTEMATIC WITHDRAWAL OPTIONS COULD HELP RETIREMENT READINESS:** Writing in plansponsor.com, Bob Melia of Lincoln Financial Group says defined benefit plans never had a bad value proposition. Rather, the move toward defined contribution plans resulted from onerous regulations and increased costs. Evidence of the original plans' advantages can be seen in the adoption of more DB-like features, such as automatic enrollment and "do-it-for-me" investing solutions, in the defined contribution marketplace. Along with these features, defined benefit plans offer systematic and guaranteed withdrawals after retirement -- something defined contribution plans have begun to explore, as well. A Pricewaterhouse Coopers Employee Financial Wellness Survey in 2014 found that 77% of employees say they prefer a retirement plan with guaranteed fixed monthly incomes for life, rather than a plan where they can take a lump sum at retirement and invest the funds themselves. By offering systematic withdrawals, retirement plans align their goals between

employers and employees. For employers, keeping more assets in the plan may decrease costs, but the retirement plan can also serve as an effective work force management tool -- many pre-retirees may want to hold onto their jobs if they lack retirement savings, but employers and younger workers want those seats vacated. By offering a higher level of retirement readiness and different retirement income solutions, the plan can provide a resource for employees to fund their retirement years. At times, plan sponsors have wanted employees to withdraw their balances at retirement. They did not want the fiduciary responsibility for the retirement savings of former employees but, that may be changing. Melia predicts that a greater willingness by plan sponsors to help employees with drawing down assets, encouragement from regulators to provide lifetime income options, and employers' desire for employees to have greater retirement security will lead more sponsors to offer systematic withdrawal solutions. As always, see item 18 below. Still the one.

**2. STATE PENSION SYSTEMS REACH 80% FUNDING:** The ratio of pension assets to liabilities, or funding ratio, for 131 state sponsored defined benefit retirement systems was 80% in 2014, up from 74% in 2013, according to a Wilshire Consulting report analyzed by plansponsor.com. Wilshire forecasts a long term median plan return equal to 5.99% per annum, 1.66 percentage points below the median actuarial interest assumption of 7.65%. However, it is important to note that Wilshire's assumptions range over a conservative 10-year time horizon, while pension plan interest rate assumptions typically project over 20 to 30 years.

**3. S&P PENSION FUNDED STATUS INCREASES 6% IN FEBRUARY:** The estimated aggregate funding level of pension plans sponsored by S&P 1500 companies increased from 74% as of January 31, 2015 to 80% as of February 28, 2015, according to Mercer. Increases in interest rates used to calculate corporate pension plan liabilities coupled with gains in equity markets increased funded status by 6%. The estimated aggregate deficit of \$486 billion as of February 28, 2015 improved by \$168 billion from the end of January, which is the largest single month improvement seen since Mercer has tracked this information in 2007. The improvement in February essentially wiped out the decreases in funded status seen in January, with overall funded status down just \$18 billion from the

\$504 billion deficit measured at the end of 2014. S&P 500 price index gained 5.5% in February. The MSCI EAFE index gained 5.8%. Typical discount rates for pension plans as measured by the Mercer Yield Curve increased by 27 basis points to 3.60%.

**4. INDIVIDUALS LEAD PENSION FUNDS IN INDEXING:** More individuals are pouring money into so-called passive investing or index funds, which aim to match performance of the main stock and bond markets, according to *New York Times*. However, larger institutions like pension funds and endowments have been slower to follow suit, despite potential for higher returns and lower fees. These bigger institutions still tend to rely on an army of asset managers and consultants, who charge higher fees but promise better returns through alternative investments like private equity and hedge funds. However, many of such investments do no better, or even worse -- than index funds. Critics say many public fund officials favor active management despite its higher costs because they do not want to index themselves out of a job. Some individuals might have ties to Wall Street or might be swayed by some perks of active management, like fancy investment conferences in Florida (really?). The penchant for index funds can be seen in the mutual fund market, where \$14 trillion in assets is held largely by individuals. The percentage invested in passive index-matching strategies has more than doubled since 2004, to 30% from 13.8%. One reason is that for the five years ended December 2014, only 32% of active stock fund managers beat their target market index, but the percentage of institutional investments in index-tracking strategies is a good deal smaller -- about 19.2% for public pension plans and 11.2% for corporate plans. While the total for public funds has risen recently, the move has been offset by institutions' hefty commitments to alternatives. The higher-fee alternatives include private equity, hedge funds, real estate and commodities, some of which offer hope of higher or less volatile returns than those produced by public markets.

**5. SUSTAINABILITY 101:** There has been considerable commentary on the sustainability of the New Hampshire Retirement System, with almost as many definitions of "sustainable" and "sustainability" as there are people using those terms. By definition, something is sustainable if it can be maintained at a certain level, with few changes, for a long period. NHRS clearly meets that definition.

Digging a little more deeply than the dictionary definition, here are some additional criteria pension plans must meet to be considered sustainable:

- **A sustainable pension plan has a reasonable benefit design.** NHRS provides a modest benefit of under \$20,000 per year, on average, to more than 31,000 retirees or their beneficiaries. Due to recent changes to the pension plan, future retirees can expect to receive even less benefits.
- **A sustainable pension plan has a commitment from the plan sponsor regularly to fund the plan.** The New Hampshire Constitution requires NHRS trustees to set an actuarially sound employer contribution, and requires employers annually to pay those rates in full.
- **A sustainable pension plan will have sufficient funds to pay future benefits as they come due.** As a result of a new reporting standard from Governmental Accounting Standards Board, NHRS is required annually to calculate whether there will be sufficient assets to pay benefits as they are due. Result of this calculation is that the retirement system is posed to meet its obligations.
- **A sustainable pension plan has a strong governance process.** NHRS is overseen by a board of trustees consisting of public members, employee members and employer members.

Hold on there: does not the retirement system's unfunded actuarially accrued liability prove that NHRS is unsustainable? In a word, no. Having an unfunded liability does not mean that a pension plan is unable to pay the benefits for which it is presently obligated or to meet current cash flow requirements. Because of the long-term nature of pensions, funding gaps can be filled gradually, over time. Most of the current UAAL is the result of what proved to be short sighted public policy decisions made more than 20 years ago, which resulted in under-funding the plan. Those decisions have since been addressed. In fact, since 2007, nearly 90 changes were made to the plan. These changes include the establishment of an actuarially sound plan to pay down this liability and return the retirement system to full funding over the next 25 years. Under this plan, employers 20 years from now will

be paying down the debt at a similar percentage of payroll as employers are today. Think of the unfunded liability as a hole which needs to be filled. Unsustainable plans are those with a deficit, which are either failing to fill the hole or still digging it. NHRS is not one of those plans. One final thing to keep in mind: sustainability is not measured in weeks, months or single years. Measuring sustainability of a defined benefit pension plan such as NHRS in those increments is like weighing a baby every few hours to see if he is growing properly. Pension plans operate on a long time horizon. Members work 10, 20, 30, even 40 years, and draw a pension for many years after retirement. If one only focus on a few points in time or takes raw data out of context to assess sustainability, one is likely to see a distorted picture. Like a 25-year mortgage, the unfunded liability is paid down over time. There is no basis for surprise or concern that the outstanding balance does not decline materially for many years. Suggestion to trustees and participants: make a copy of this item, enlarge it and keep it posted where it can be seen as a constant reminder.

**6. PENSION FUNDING STATUS IMPROVES:** Funded status of the 100 largest corporate defined benefit pension plans improved by \$80 billion during February, 2015 as measured by the Milliman 100 Pension Funding Index. The deficit fell to \$303 billion from \$383 billion at the end of January, due to an increase in benchmark corporate bond interest rates used to value pension liabilities, and robust investment gains. As of February 28, 2015, the funded ratio increased to 83.3%, up from 79.6% at the end of January. Projected benefit obligation, or pension liabilities, decreased to \$1.816 trillion from \$1.876 trillion at the end of January. The change resulted from an increase of 25 basis points in the monthly discount rate to 3.63% for February, from 3.38% for January. While January's discount rate was the lowest in the history of the Milliman 100 PFI, February's discount rate was not much better, ranking as the second lowest in the study's history. The market value of assets increased by \$20 billion as a result of February's investment gain of 1.70%. The Milliman 100 PFI asset value increased to \$1.513 trillion, up from \$1.493 trillion at the end of January. By comparison, the 2014 Milliman Pension Funding Study reported that the monthly median expected investment return during 2013 was 0.60% (7.4% annualized). The expected rate of return for 2014 will be updated in the 2015 Milliman Pension Funding

Study, due to be released later.

**7. PRIVATE PENSION PARTICIPANTS NEED BETTER INFORMATION WHEN OFFERED LUMP SUMS IN EXCHANGE FOR LIFETIME BENEFITS:** United States Government Accountability Office has issued a report to the Ranking Member, Committee on Ways and Means, House of Representatives, entitled “PRIVATE PENSIONS - Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits.” Little public data are available to assess the extent to which sponsors of defined benefit plans are offering participants immediate lump sums to replace their lifetime annuities, but certain laws and regulations provide incentives for use of this practice. Although the U.S. Department of Labor has primary responsibility for overseeing pension sponsors’ reporting requirements, it does not require sponsors to report such lump sum offers, making oversight difficult. Pension experts generally agree that there has been a recent increase in these types of offers. By reviewing the limited public information that is available, GAO identified 22 plan sponsors that had offered lump sum windows in 2012, involving approximately 498,000 participants and resulting in lump sum payouts totaling more than \$9.25 billion. Most of these pay outs went to participants who had separated from employment and were not yet retired, but some went to retirees already receiving pension benefits. Sponsors are currently afforded enhanced financial incentives to make these offers by certain laws and regulations issued by the U.S. Department of the Treasury (specifically the Internal Revenue Service) governing the interest rates and mortality tables used to calculate lump sums. Participants potentially face a reduction in their retirement assets when they accept a lump sum offer. The amount of the lump sum payment may be less than what it would cost in the retail market to replace the plan’s benefit because the mortality and interest rates used by retail market insurers are different from the rates used by sponsors, particularly when calculating lump sums for younger participants and women. Participants who assume management of their lump sum payment gain control of their assets but also face potential investment challenges. In addition, some participants, may not continue to save their lump sum payment for retirement but instead may spend some or all of it. GAO reviewed 11 packets of informational materials provided by sponsors offering lump sums to as many as 248,000 participants, and found that the packets

consistently lacked key information needed to make an informed decision, or were otherwise unclear. Using various sources, including financial advisors, federal agency publications, laws and regulations, GAO identified eight key types of information that participants need to have a sound understanding of a lump sum offer. While GAO did not review the packets for compliance or legal adequacy, most packets provided a substantial amount of this key information. However, all of the packets GAO reviewed lacked at least some key information. For example, the relative value notices were often unclear about how the value of the lump sum compared to the value of the lifetime monthly benefit provided by the plan. Similarly, many packets did not clearly indicate the interest rate or mortality assumptions used, limiting participants' ability to assess how the lump sum payment was calculated. Further, few of the packets informed participants about the benefit protections they would keep by staying in their employer's plan -- full or partial protections provided by the Pension Benefit Guaranty Corporation, the agency that insures defined benefit pensions when a sponsor defaults. This omission is notable because many participants GAO interviewed cited fear of sponsor default as an important factor in choosing the lump sum.

**8. AFFLUENT RETIREMENT LIFESTYLE COSTS A PRETTY PENNY:** A recent Legg Mason survey finds sound affluent U.S. investors predict their average net retirement expenses could top \$2.5 million without significant lifestyle changes. Seventy-two percent of respondents say their primary goal of investing was to maintain current lifestyle later in life, including through retirement. To accomplish this goal, Americans on average will need to save at least \$2.5 million before they retire. Asked if they were making progress on this challenging goal, 38% said they were not doing well or only doing somewhat well. Taking all retirement readiness factors together, Legg Mason finds just 40% of those surveyed say they are confident in their ability to retire at the age they want to, while 60% were either not confident or somewhat confident. Importantly, Legg Mason restricted the U.S. portion of the Global Investment Survey to more affluent investors with a minimum of \$200,000 in investable assets, not including their homes. Most of these individuals identify retirement preparation as a top reason they are saving, they spend an average 457 hours annually worrying about money and retirement issues. This figure translates to about one hour and 20 minutes each day thinking

or worrying about money, while those in the top 10% report spending two to three hours each day thinking or worrying about money, for a total of more than 1,000 hours each year. Top issues investors fear could prevent them from living the lifestyle they want later in life are having a catastrophic event that uses up retirement funds; living longer than retirement assets last; and income not keeping up with inflation. Here are some other key findings:

- 42% expect to cut back on their lifestyle in retirement so they do not outlive their assets;
- 31% think they will need more money in retirement but are afraid to take the investment risk to get there;
- 30% can save more, they just do not; and
- 26% have more debt than they should.

If they lost their job today, 21% of affluent investors said they would have a hard time paying their bills in six months. The survey found that if they were to start working and investing all over again, one-quarter said they would not do anything differently, while 14% said they would take more risk. Just 9% said they would take less risk.

**9. HARDEST WORKING U.S. CITIES:** March 6 was Employee Appreciation Day, and across the country employees pour their hearts and souls into their jobs. But there are some employees who go above and beyond, earning their employers' gratitude all that much more. According to WalletHub's new data evaluating labor force participation rates, average hours worked per week and number of workers with multiple jobs, the following cities are considered the hardest working American cities:

- Anchorage, Alaska, average workweek hours: 40.7
- Virginia Beach, Virginia, average workweek hours: 40.1
- Plano, Texas, average workweek hours: 40.6
- Cheyenne, Wyoming, average workweek hours: 39.8
- Irving, Texas, average workweek hours: 40.1
- Jersey City, New Jersey, average workweek hours: 39.5
- Garland, Texas, average workweek hours: 39.5
- San Francisco, California, average workweek hours: 39.6
- Denver, Colorado, average workweek hours: 38.9
- Chesapeake, Virginia, average workweek hours: 39.3

Irrespective of Plano's reputation as a hard working city, it also has another distinction, which can be found at <https://www.youtube.com/embed/pELwCqz2JfE?rel=0&autoplay=true>.

**10. BILLIONAIRES IN SPORTS:** Southflorida.citybizlist.com reveals some of the richest sports team owners from the *Forbes* list of global billionaires:

- Steve Ballmer, net worth: \$21.2 billion, LA Clippers
- Paul Allen, net worth \$17.5 billion, Seattle Seahawks
- Mikhail Prokhorov, net worth: \$9.9 billion, Brooklyn Nets
- Micky Arison, net worth: \$7.1 billion, Miami Heat
- Robert Kraft, net worth: \$4.3 billion, New England Patriots
- Jerry Jones, net worth: \$4.2 billion, Dallas Cowboys
- Mark Cuban, net worth: \$3 billion. Dallas Mavericks
- Stephen Bisciotti, net worth: \$2.7 billion, Baltimore Ravens
- Arthur Blank, net worth: \$2.5 billion, Atlanta Falcons
- Robert McNair, net worth: \$2.4 billion, Houston Texans
- John Henry, net worth: \$1.6 billion, Boston Red Sox
- Michael Jordan, net worth: \$1 billion, Charlotte Hornets

**11. MUSINGS:** We came across a nifty website (<http://playback.fm/birthday-song>) that identifies the number one song on the day of your birth, or any other date you choose. You can then watch and listen to a video of the song. One other interesting thing: the site also has a dynamic time clock, which tells you how many *minutes* you have been alive.

**12. IRS WEBINAR ON RETIREMENT PLAN LOANS TO PARTICIPANTS:** Internal Revenue Service puts on free phone forums and webinars featuring IRS employees discussing retirement plan topics. On March 26, 2015, at 2:00 p.m. Eastern Time, IRS will present "Retirement Plan Loans to Participants." Learn about

- What type of plans can make loans to participants
- What are the conditions a plan must follow to make loans
- What are the required terms of a plan loan
- How plan loans may be taxable under IRC Section 72(p)
- When plan loans violate the prohibited transaction rules of IRC Section 4975
- How to fix plan errors involving loans

Estimated duration is sixty minutes. Register and you will receive a confirmation email:  
<http://www.visualwebcaster.com/IRS/101560/reg.asp?id=101560>.

**13. DILLERISMS:** The only time I ever enjoyed ironing...was the day I accidentally poured gin in the steam iron. Phyllis Diller

**14. STUFF YOU DID NOT KNOW:** In English pubs, ale is ordered by pints and quarts. So in old England, when customers got unruly, the bartender would yell at them "mind your pints and quarts, and settle down." It is where we get the phrase "mind your P's and Q's."

**15. TODAY IN HISTORY:** In 1956, Dow Jones closes above 500 for 1<sup>st</sup> time (500.24).

**16. 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.

**17. 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>.

**18. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.**

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