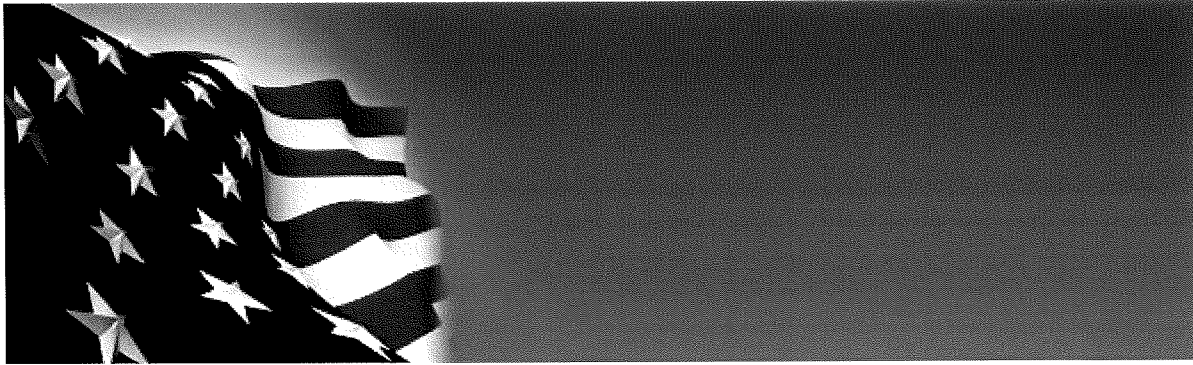


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CYPEN & CYPEN NEWSLETTER for MAY 7, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. NCPERS STUDIES INCOME INEQUALITY HIDDEN ECONOMIC COST OF PREVAILING APPROACHES TO PENSION REFORMS:

The National Conference on Public Employee Retirement Systems has released a report entitled "INCOME INEQUALITY - Hidden Economic Cost of Prevailing Approaches to Pension Reforms." The struggle for social and economic justice in the United States cannot be won unless we address the issue of rising income inequality. Income inequality is related to many challenges we face in America today, including retirement security. Do pension reforms of the past three decades exacerbate income inequality? Does rising income inequality in turn dampen the economy? The purpose of this study is to address those questions. The study reviewed changes in pensions resulting from pension reforms at national and state levels. At the national level, the key change has been a trend of conversion of defined benefit pension plans into defined contribution plans. At the state and local levels pension changes consisted of cuts in benefits,

increased employee contributions, and conversion of DB plans into DC plans. These changes have a negative impact on plan participants and beneficiaries, as well as on local economies. Therefore, those changes are referred to as negative pension changes. The study analyzed the relationship between pension changes and income inequality at national and state levels. At the national level, the data allowed the authors to examine trends in pension changes, income inequality, and economic growth during the 1980s, 1990s, and 2000s. At the state level, these trends could be examined only during 2000–2010. The analysis found that income inequality was highly correlated with the trend toward conversion of DB into DC plans. The correlation between income inequality and percentage of workforce (public and private) covered by DB plans was $-.894$. This correlation is robust, and means that the lower the percentage in the workforce with DB plans, the higher the income inequality. Other factors that had a robust inverse relationship with income inequality included changes in the percentage of the workforce in unions, marginal (top income) tax rates, and the rate of investment in public education. Inverse relations mean that higher income inequality is the result when the percentage of the workforce in unions; marginal tax rates; and the rate of investment in public education are all lower. The national level analysis also examined the relationship between income inequality and economic growth. The analysis shows that this correlation was $-.553$, meaning that the higher the income inequality, the lower economic growth. Other factors considered in the analysis included rate of investment in public education and multifactor productivity. Multifactor productivity refers to economic inputs including labor, capital, and raw materials. Higher-level analysis of the national data using advanced multivariate techniques was not viable due to limitations of the available data. Yet it is clear from the empirical data from 1980s, 1990s, and 2000s that when DB plans are changed into DC plans, income inequality rises and economic growth dampens. Also, just by looking at the raw data one can conclude that if the trend toward conversion of DB into DC plans during the past 30 years did not exist, 15 million more US workers would be covered by a lifetime guarantee of a DB plan. (See Item 14 below.) The analysis found that the higher the number of negative pension changes made by a state government, the higher is the increase in income inequality in that state. Again, by negative changes the authors mean cuts in benefits, increases in employee contributions, and conversion of DB plans into

DC or hybrid plans. The data show that the correlation between negative pension changes and income inequality during 2000–2010 was $-.378$. This correlation means that the more negative changes a state makes to its pension plan, the higher is the income inequality in that state. The state level data allowed the authors to do advance multivariate analysis to examine the relationship between pension changes and income inequality and between income inequality and economic growth. The analysis shows that with a single negative change in pensions in a state, income inequality increases by 15% in that state! This relationship holds true even when other factors contributing to income inequality, such as lack of investment in education, are taken into account. Next, the analysis examined the relationship between income inequality and economic growth in each of the 50 states during 2000–2010. The analysis shows that states with rising income inequality had slower economic growth. The analysis found that for each one-unit increase in income inequality in a state, the rate of economic growth in that state was reduced by about 18%! By one unit the authors mean the ratio of incomes of top and bottom quintiles changes by one. Again, this relationship holds true even when other factors affecting economic growth, such as productivity, are taken into account. The implication is that policymakers should pay serious attention to income inequality and its hidden economic cost to taxpayers before they make the changes that diminish DB pensions. Rather than making changes such as increasing employee contributions, cutting benefits, converting DB plans into DC or hybrid plans, and so forth, policymakers should close tax loopholes. A recent study of a number of states shows that on average states gave away twice as much in economic development subsidies and loopholes as they were required to pay into annual pension contributions. Whereas taxpayer money given through loopholes and subsidies often ends up in overseas tax havens, pension checks are spent locally and stimulate local economies. The study includes a chart showing annual employer normal pension costs compared with annual costs of taxpayer money given away in corporate subsidies and tax loopholes in selected states. Florida's annual employer normal pension costs are \$0.91 billion; annual cost of corporate subsidies is \$3.81 billion; thus, Florida's annual pension costs as a percentage of corporate subsidies is 24%! It is not difficult to see what is happening to public employees in Florida, when the state gives away four times as much in loopholes as it is required to

pay for pension contributions.

2. SOCIAL SECURITY STRONGER THAN MOST REALIZE: Despite news stories predicting demise of Social Security, onwallstreet.com says that are also experts who say that rumors of the program's death have been greatly exaggerated. They argue that Social Security, a program that began back in 1935 and that has never missed a payment, is unlikely to be left short of funds by Congress. In fact, the same boomers who are seen as taxing the system's ability to pay are the very ones who will make the already affluent senior lobby about 50% larger and significantly bigger as a share of the total electorate, in 15 years. Social Security will have an increasingly powerful lobby working on its behalf as time goes by. And Social Security might just have the best return on investment: rather than discount future benefits, one expert argues that advisers should recommend to any client who is feeling financially strapped and thinking of taking his benefits early, to draw on other investments, even 401(k) or IRA funds, and wait until 70 to get the maximum benefit. Simply waiting until 70 to collect can be the best long term return money can buy. Indeed, for an average middleclass person age 66 with \$1,800 monthly Social Security benefit, matching that with a privately issued annuity that has an inflation adjustment and spousal benefit, would cost \$500,000! To the extent that Social Security benefits can cover a client's or couple's expenses, they are free to take more risk with their invested assets. See Item 14 below.

3. FUNDED STATUS OF PENSIONS INCREASES: Plansponsor.com reports that the funded status of the typical U.S. corporate pension plan increased 2.9% points in April to 90.1%. Public plans, endowments and foundations exceeded their targets for the month, as asset values rose. For the typical U.S. corporate plan, assets in April increased 0.7%; while liabilities fell 2.6% as the Aa corporate discount rate rose 20 basis points to 4.06%. Plan liabilities are calculated using the yields of long term investment grade bonds. Higher yields on these bonds result in lower liabilities. The funded status is 0.5 percentage points lower than at this time last year, and 2.8 percentage points higher than at the beginning of the year. Public defined benefit plans in April exceeded their return target by 0.9%, as assets returned 1.5%. For endowments and foundations, the real return in April was 1.2% as assets returned 1.5%. Year over year,

endowments and foundations are behind their inflation plus spending target by 1.1%.

4. MORE NONRETIRES WILL RELY ON SOCIAL SECURITY:

Although the Social Security program continues to face long term funding challenges, U.S. nonretirees are more likely to say Social Security will be a major source of income in their retirement than they have been at any point in the last 15 years. The current 36% of nonretirees expecting to heavily rely on Social Security is roughly 10 percentage points higher than a decade ago. In addition to the 36% of nonretirees expecting Social Security to be a major source of retirement income, another 48% believe it will be a minor source. Fourteen percent do not expect Social Security to be a source of retirement funds for them at all. Generally speaking, the older nonretirees are the lower their household income is, the more they expect to rely on Social Security as a major source of retirement funds. Close to half of nonretirees aged 55 and older and of nonretirees whose annual household income is less than \$30,000, say Social Security will be a major source of funds. Even as nonretirees increasingly expect to rely on Social Security in retirement, they are still most likely to name retirement investment accounts, such as 401(k) plans and Individual Retirement Accounts, as a major source of retirement funds. Currently, 49% say such plans will be a major source, essentially unchanged from last year but up slightly from an average of 45% from 2009-2013. In the past, as many as 58% of nonretired Americans expected to rely on 401(k)s or other retirement savings accounts as a major source of money in retirement. That came in early 2001, shortly after the dot-com economic boom. After 401(k) plans and Social Security, the next most common expected retirement funding sources are regular savings accounts and CDs (27%), work-sponsored pension plans (25%), part-time work (21%), home equity (21%), and individual stocks or mutual fund investments (20%). These results are based on Gallup's annual Economy and Personal Finance survey.

5. GENERATION X EXPECTS TO NEED AN AVERAGE OF \$1.5 MILLION IN RETIREMENT!: A survey reported by PMS has revealed that more than half believe they will need \$1 million or more to be comfortable in retirement. Generation X expects to need an average of \$1.5 million for retirement while baby boomers average expectation

is slightly lower at \$1.3 million. However three-quarters of boomers have yet to reach the \$1 million milestone. The survey measured attitudes on retirement preparedness of Generation X, defined as those between ages of 35 and 49, and baby boomers, between 50 and 68. In the survey of over 1,000 adults with investable assets of \$50,000, 65% of Generation Xers supported "I believe I am solely responsible for my retirement (no Social Security, employer contribution, inheritance, etc.)" versus 45% of boomers. It shows that while one in seven of all survey respondents are still coping with the effects of the Great Recession, seven out of 10 changed their financial behavior as a result. Fifty-one percent of Gen Xers say they are saving more for retirement, compared to 37% of boomers.

6. ANOTHER ENEMY OF YOUR RETIREMENT: What government gives with one hand, it takes back with the other, according heraldextra.com. We experience the taxation of Social Security benefits as a tax on money withdrawn from our retirement plans. Many middle income retirees are now paying taxes on those withdrawals at a 28.25% rate. -- higher than the 15% top rate they paid throughout their working careers. To put that 28.25% rate in perspective, 28% is the rate couples will pay on taxable incomes over \$151,201 this year. (For singles, the figure is \$90,751.) Retirees with Social Security benefits can pay 28.25% on withdrawals from their retirement plans, when income is well below \$100,000. What happened? Simple...our elected representatives are busy. The legislation for 401(k) plans traces to 1978, but the real growth of these plans started in the mid-1980s, about the same time as the 1983 reform of Social Security. That reform put in place a little-noted provision for the taxation of benefits. Few noticed or discussed the tax provision. It affected only about 3% of all retirees: the ones with the most income. But the tax provision is unusual. It is one of the few provisions in our tax code that are not indexed to inflation. As a consequence, an obscure tax that hit a handful of affluent retirees in 1984 today hits 30% of all retirees. And since the tax law still is not indexed, it will hit even more of the next generation for this reason, some people call it "the Tax Torpedo." Over the last 30 years, the first enemy of our retirement savings plans was high fees, particularly in 401(k) and 403(b) plans. Why does the burden fall primarily on middle income retirees? Well, Social Security benefits are added to taxable income by a formula. But once 85% of all benefits have been added to

taxable income, the tax is done. Once done, more income pays taxes at normal rates. Basically, middle income taxpayers have to run a gauntlet of punishing tax rates. People with lower incomes do not pay the tax. People with higher incomes have already paid it. Inescapably, taxation of Social Security benefits hits middle income retirees hardest and the damage is not minor, even if it is smaller than the damage done by high fees. Fees of 1% would cut 2.8 years of final income off the accumulation. But a 15% tax reduces the accumulation by another 2.1 years. Bumping the tax rate to 28.25% subtracts another 1.8 years. It all makes a difference in coping with the problem of retirement security. The final absurdity in this law is that it hits retirees so hard it doubles their income tax bill, or more, while adding only 4% to Social Security revenues. What a deal.

7. HABITS OF HIGHLY CONFIDENT RETIREES: Concern about retirement readiness is top of mind for many employers, their benefit advisers and especially their employees. A survey reviewed by ebn.benefitnews.com, found 92% agree they stand to learn a few things about retirement confidence from current retirees. Seven habits that highly confident retirees practiced throughout their working career are easily understandable and easy for today's participants to emulate:

- Essential habit No. 1: making the most out of the savings plan. Many participants ignore their plans, but engaged participants regard their plan as a source of information and guidance. They want to know the current best thinking about retirement savings and they act accordingly.

- Essential habit No. 2: increasing contributions to savings plan when possible. Most confident and successful retirees report increasing their contribution percentage after annual pay hikes, promotions and bonuses. Auto-escalation features can help all participants achieve this habit automatically.

- Essential habit No. 3: estimating retirement income. Successful retirees use in-plan tools and external resources to understand how their savings might translate into post-retirement spending.

- Essential habit No. 4: reviewing strategy on a regular basis. Successful, confident retirees ask the question, “is this the way to get where I am going?” It is an all-inclusive question, from their contribution to their work plan, through to their additional savings and Social Security estimates.
- Essential habit No. 5: changing investment mix as they age. A 25-year old with forty years of earning potential ahead of him should not have the same asset allocation as a 65-year old set to retire next week.
- Essential habit No. 6: enrolling early. For some plan participants, unfortunately, it is too late to start early. But the clear connection between tenure in a workplace savings plan and retirement security should motivate late starters to get going.
- Essential habit No. 7: saving the maximum. Successful retirees sacrificed to save the maximum, including the “catch up” provisions allowed for participants older than 50.

8. 36TH ANNUAL POLICE OFFICERS' AND FIREFIGHTERS' PENSION TRUSTEES' SCHOOL: The 36th Annual Police Officers' & Firefighters' Pension Trustees' School will take place on June 2-4, 2015. You may access information and updates about the Conference, including area maps, a copy of the program when completed and links to register at the Residence Inn Tallahassee Universities at the Capitol. Please continue to check the FRS website for updates regarding the program at www.myflorida.com/frs/mpf. All police officer and firefighter plan participants, board of trustee members, plan sponsors and anyone interested in the administration and operation of the Chapters 175 and 185 pension plans should take advantage of this unique, insightful and informative program.

9. FPPTA 31ST ANNUAL CONFERENCE: The Florida Public Pension Trustees Association's 31st Annual Conference will take place on June 28 through July 1, 2015 at the Boca Raton Resort & Club, Boca Raton. A link on FPPTA's web site, www.fppta.org, will take you to the Boca Raton Resort & Club site to make your room reservations. You may access information and updates about the Conference at FPPTA's website. All police officer and firefighter plan participants, board of trustee members, plan sponsors and anyone

interested in the administration and operation of the Chapters 175 and 185 pension plans should take advantage of this conference.

10. APHORISMS: How come it takes so little time for a child who is afraid of the dark to become a teenager who wants to stay out all night?

11. TODAY IN HISTORY: In 1914, U.S. Congress establishes Mother's Day. We wish all mothers a wonderful Mother's Day.

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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