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# CYPEN & CYPEN NEWSLETTER for JUNE 25, 2015

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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

## **1. THE FUNDING OF STATE AND LOCAL PENSIONS, 2014-2018:**

Center for State & Local Government Excellence has released its 2015 report of State & Local Government Pension Funding, and finds that most public pension plans have improved their funded status. The year 2014 was always going to be a pivotal one for the funded status of public pension plans because, under the old GASB 25 accounting standards, the disastrous stock market performance of 2009 rotates out of the smoothing calculations for the majority of plans that use a five-year averaging period. But 2014 also became pivotal because it was the first year that plan sponsors reported under GASB's new accounting standards for their financial disclosures. The new GASB 67 standards involve two major changes. First, assets are reported at market value rather than actuarially smoothed. Second, in cases when assets are projected to fall short of future benefits, liabilities are valued using a blended discount rate. Although GASB standards

apply to financial reporting only, when GASB 25 was in effect, most plans also used the same standards for funding purposes. Under GASB 67, however, plans are now using separate standards for reporting and funding. For reporting in their financial documents, all plans in the sample that have released 2014 data adopted the market valuation of assets as required by GASB 67, but only seven plans determined it necessary to use a significantly lower blended discount rate. For funding purposes (that is in plans' actuarial valuations), they maintained the traditional approach used under GASB 25 of using smoothed assets and expected long term gains for discounting. The brief focuses on the data used in plans' actuarial valuations because they provide the basis for historical comparisons and for funding decisions. The discussion is organized as follows. The first section reports that the ratio of assets to liabilities for the 150 plans in the Public Plans Database increased from 72% in 2013 to 74% in 2014. The second section shows that the required contribution increased from 17.8% to 18.6% of payrolls, while the percentage of required contributions paid increased from 82% to 88%. The third section revalues liabilities and recalculates funded ratios using the riskless rate, as advocated by most economists for reporting as opposed to funding purposes. The fourth section projects funded ratios for sample plans for 2015-18 under two economic scenarios. The fifth section briefly describes the information reported in the financial statements under the new GASB standards. The final section concludes that, if plans achieve their assumed returns, the public pension landscape should continue to improve over the next few years. For your information, the following chart displays ratio of assets to liabilities for state and local plans, 2000-2014 for the Florida Retirement System:

- 2001 -- 117.9%
- 2004 -- 112.1%
- 2007 -- 105.6%
- 2008 -- 105.3%
- 2009 -- 87.9%
- 2010 -- 88.0%
- 2011 -- 86.9%
- 2012 -- 86.4%
- 2013 -- 85.4%
- 2014 -- 86.6%

15-07 SLGE Funding of State and Local Pensions 2014-2018.

**2. FOUR REASONS NEW JERSEY'S PENSION RULING IS NOT A WIN FOR THE STATE OR ITS EMPLOYEES:** New Jersey's top court overturned a lower court's ruling that Governor Chris Christie had violated a 2011 pension law. The decision means the state does not have to pay its pension fund the \$1.6 billion Christie had promised to pay when employees agreed to contribute more to their retirement accounts, according to governing.com. The ruling is largely hailed as a political victory for the governor, who will announce whether he is running for president. It is also a temporary financial victory for New Jersey. But there are many more reasons why the win is fleeting, and will ultimately place more pressure on a financially beleaguered state that can ill afford it. Here is why:

- **New Jersey still has a really high pension liability.** Although the court said New Jersey was not contractually required to put aside the actuarially recommended state contribution each year. That does not mean it gets out of what it owes to retirees. The roughly \$90 billion unfunded pension liability across the state's three major plans will likely increase next year if the state does not start putting in enough money to pay down that debt. Incidentally, thanks to new pension accounting rules, New Jersey's pension liabilities jumped dramatically this year precisely because of the state's history of skipping pension payments. Both Moody's Investors Service and Standard & Poor's credit rating agencies issued statements that cut short any celebration of the ruling, noting that the decision helps the state avoid a credit crunch for now. Moody's lead analyst for the state of New Jersey, warned that it also perpetuates severe pension underfunding and rapid growth of state liabilities. And S&P noted that Christie and the legislature are far apart on how to manage the long-term pension liability, and that not finding a solution will only accelerate the state's liability growth.
- **New Jersey could still get downgraded. Again.** The three major credit ratings agencies have cut the state's general obligation bond rating three times over the past five years. Its "A" rating is the second-lowest of all 50 states, behind only Illinois. Ratings agencies generally like New Jersey's pension reform law, because it instituted some fiscal discipline for a state that had not consistently contributed to its pension fund since the turn

- of this century. The decision certainly provides the state with some increased budgetary flexibility, but if the past is any indicator, flexibility around pension payments does not bode well for New Jersey's liability position and is a key contributor to the state's current pension funding situation and deterioration in credit quality, S&P said. If the state does not find a solution to pension and other post retirement liabilities, the agency added, budget and credit pressure will accelerate and the state's rating could be vulnerable to further downgrade.
- **Retirement security for New Jersey state employees is now in doubt.** If New Jersey's retirees and about-to-be-retirees were not worried about their pensions, they should be now. The state has set aside roughly one-third of the money it said it would give them and has no plans to start making up the difference. The insolvency of New Jersey's pension system could be a real issue in the next year if lawmakers cannot resolve this crisis. Speaking at a summit on retirement security this week in Washington, D.C., the director of collective bargaining for the American Federation of State, County and Municipal Employees, called the court ruling the unfortunate result of a dysfunctional political system. To make matters worse, recruitment is at stake. We find that our younger members value pensions every bit as much as our older ones. Although there is certainly a trend among younger workers in public and private sectors not to stay at their jobs as long as previous generations, many drawn to government are lifers: teachers, police officers and firefighters, for example. They are not looking to move on necessarily, so pensions really are a good fit for this workforce.
  - **New Jersey still has other big budget problems.** As outlined by a Volcker Alliance report Monday, an outsized pension liability is just one of several overwhelming problems facing the Garden State. New Jersey, the report found, suffers from a chronic inability to match its expenses to revenues. In addition to a pension funding gap, the state is also short about \$1 billion this year in education funding required under the State Funding Reform Act. And it has insufficient funds to address the state's growing infrastructure issues, in part because the state has been transferring money from those funds to balance the budget in recent years.

The report noted New Jersey's frequent use of budget gimmicks to balance the budget. It is a practice that has been going on since the 1990s, and it is allowed the state to mask a deep-seated fiscal imbalance. This reinforces the state's ongoing reliance on one-time budget solutions and will perpetuate large structural imbalances and a rapidly increasing pension burden.

**3. THE TOP TEN FIDUCIARY ERRORS:** From Cammack Retirement, here are the top ten most common errors that fiduciaries make:

- **Failure to identify all fiduciaries.** There are often several retirement plan fiduciaries in an organization, and probably the most egregious error is failure to identify all such individuals. The consequences of this omission can be costly, as it is not uncommon for individuals who had no idea that they were fiduciaries to be called to testify in court regarding their fiduciary conduct.
- **Failure to provide proper fiduciary liability insurance.** It is extremely important to avoid this mistake, since fiduciary liability is personal, and not corporate. If a fiduciary is not properly insured, his own personal assets could be used to settle claims. Many plan sponsors erroneously assume that retirement plan fiduciaries are covered by some sort of insurance, such as directors and officers or employment practice liability policies.
- **Failure to understand the types of third-party fiduciaries.** Though many service providers will claim to be fiduciaries of some sort, such claims may or may not be valid.
- **Insufficient training of fiduciaries.** This failure has recently surfaced as a Department of Labor audit issue. New fiduciaries should receive comprehensive training, with refresher training provided to all fiduciaries on a regular basis. Training should also be documented in the meeting minutes, with copies of training materials retained in the plan's permanent file.
- **Failure to take appropriate actions and document such actions.** Though this may sound straightforward, some fiduciary

committees suffer from inertia due to an inability to reach consensus. But the bottom line is that much litigation results from fiduciaries failing to take appropriate action, so it important for actions to be completed and documented in the form of meeting minutes. Minutes of a meeting are nearly as important as the meeting itself, and all fiduciaries should carefully review meeting minutes to ensure that that documentation of all actions is complete and accurate. Lack of thoughtful documentation is an open invitation to litigation.

- **Spending too much time on plan investments.** Of course investments matter, but committee meetings often suffer from a laser-like focus on investments at the expense of other areas of critical importance to fiduciaries, such as remitting plan contributions in a timely fashion, following the plan document, and monitoring/controlling plan expenses.
- **Spending too much time on the wrong investments.** Mutual funds, and, to a lesser extent, variable annuities, are fairly easy to evaluate. Stable value and target date funds, are less so. Guess which category generally receives much more attention at committee meetings? Often, since stable value and target date funds make up the largest component of plan assets and contributions, paying too much attention to mutual funds comes at the expense of asset categories in which participants are more likely to invest. The prudent plan sponsor should probably dedicate an entire committee meeting solely to stable value fund evaluation, and conduct a separate meeting dedicated to target date funds.
- **Failure to follow the plan's investment policy statement.** An investment policy statement is to investment due diligence what a plan document is to plan administration: a living, breathing document that should be referenced in every committee meeting. Accordingly, an IPS should be of a reasonable length and easy to understand, so that it can be readily implemented. The IPS should not be so constricting that it prevents the committee from acting appropriately under the circumstances.
- **Failure to properly benchmark plan expenses.** All plan expenses directly or indirectly paid to all service providers,

including revenue sharing, should be thoroughly documented and benchmarked against the appropriate peer plans.

- **Spending too little time on participant outcomes.** Most participants make mistakes in managing their retirement plan assets, which results in outcomes that are less than desirable for both the employee and the employer. For example, employees may lack sufficient money to retire, and therefore need to extend their working careers at the employer firm by up to several years. But a thorough examination of participant outcomes is still in the developmental stages in many plans.

If fiduciaries can avoid committing these mistakes, their plans' due diligence process would be much improved. While a better process may not guarantee better results -- a prudent process, rather than actual results, is the focus of entities such as the Department of Labor. By bringing these common errors to light, hopefully plan sponsors can avoid mistakes in the future.

**4. FAILING TO CONSIDER SOCIAL SECURITY MAY PAINT AN UNREALISTIC PICTURE OF DIVORCING PARTIES' FUTURE FINANCES; NEVERTHELESS, CONGRESS INTENDED TO KEEP THOSE BENEFITS OUT OF DIVORCE CASES:** Shelley and Christopher married in 1992. Shelley works in the private sector, has Social Security tax withheld from her pay. She expects to receive full benefits in 2033 at age 67. Christopher works for the police department and does not have Social Security tax withheld. He contributes to the police pension fund, and can retire with full pension benefits in 2017 at age 50. In their 2012 divorce, Christopher computed the estimated present value of his pension benefits, using a "Windfall Elimination Provision" to determine what part of those benefits were in lieu of Social Security, which is exempt from equitable distribution. Using Christopher's wages, as if covered by Social Security, predicted that his Social Security benefit at age 67 would be \$1,778 per month, using his wages for only those years in which he contributed to Social Security, predicted that his benefit at age 67 would be \$230 per month. The difference of \$1,548.00 was posited as "in lieu of Social Security." The difference between that amount and the pension amount was \$2,479 per month, with an estimated present value of \$639,720.74. The court determined the proposed present valuation would violate federal law as interpreted by

Illinois Supreme Court precedent. Christopher recalculated the present value of his pension, without the offset, as \$991,830. The court adopted that figure, and awarded Shelley about 35%. The Illinois Supreme Court affirmed, reasoning that Social Security benefits cannot be calculated until the participant collects them. Decreasing Shelley's share of Christopher's pension based on present value of hypothetical Social Security benefits that, even if he had participated in the program, might never receive is illogical and inequitable. *In re: Marriage of Shelley L. Mueller*, (Docket No. 117876) (Ill. June 18, 2015). Summary provided by Justia.

#### **5. RHODE ISLAND JUDGE APPROVES SETTLEMENT ON PENSION OVERHAUL:**

A proposed settlement to resolve years of legal wrangling over Rhode Island's landmark public pension system overhaul was recently approved by a judge who called it an imperfect but fair solution, as reported by The Associated Press. Superior Court Judge Sarah Taft-Carter overruled objections to the settlement, putting an end to nearly all the lawsuits by public sector unions and retirees against the state over the 2011 reform, which was designed to save the state \$4 billion over 20 years. The deal would preserve about 90% of the savings. The 2015 settlement agreement is not being offered as a perfect solution, nor is perfection required of it under the law, Taft-Carter wrote. Lawmakers must also approve the settlement. Roger Boudreau, who leads the Rhode Island Public Employees' Retiree Coalition, said he is comfortable and satisfied with the judge's ruling, though he said his group feels there was nothing fair about the situation they were put in. It is not a perfect remedy, but it is the best remedy we could reach under the circumstances. House Speaker Nicholas Mattiello said he is pleased with the judge's decision. He said the changes from the settlement will be incorporated into the budget, which lawmakers are considering. I always thought that under very difficult circumstances, the pension reform legislation was fair and in the best interests of the citizens of the state of Rhode Island, he said. And a court, after a full hearing, just ratified that decision. Governor Gina Raimondo said the decision is an important step toward providing certainty for municipal public employees, and is in the state's long-term interests for financial stability and economic growth. I remain grateful to all the parties that we were able to reach agreement, and I look forward to working with the General Assembly to pass legislation finalizing the settlement, the Governor said. Lt.

Gov. Daniel McKee said it will be good for the state to move on. Dozens of people testified during a five day fairness hearing in May against the settlement, and hundreds filed written objections. The settlement provides for cost-of-living increases and one-time stipends for retirees. About 59,000 past and present state employees would be affected by the deal. Unions representing municipal police, Cranston police and Cranston fire, which collectively represent about 800 people, did not accept the terms.

## **6. TEN ECONOMIC FACTS ABOUT FINANCIAL WELL-BEING IN RETIREMENT:**

The Hamilton Project has issued a new brief entitled Ten Economic Facts About Financial Well-Being in Retirement. Most households in the United States find retirement planning a daunting challenge, with good reason. Rising life expectancy and potentially exorbitant long-term care costs have increased the financial resources required to support oneself and one's spouse in retirement and old age. For many segments of the population, negligible real wage growth has made the challenge all the more difficult. Furthermore, there are multiple dimensions of uncertainty when it comes to planning for those years, including returns on investments, health, longevity, Social Security benefits, and the level and type of support available from family members. Even with substantial planning, unanticipated events such as losing a job near retirement age, developing a serious illness, or the early death of a spouse can put pressure on even the most well-planned retirement portfolios. Achieving financial well-being in retirement requires difficult choices and trade-offs long before retirement age. Individuals need to make decisions about how much to spend and how much to save. It is difficult to weigh the benefits of saving for retirement against day-to-day expenses, paying for a child's college education, saving for a small business, or spending money on pleasures like vacations and eating out. But aside from the decision about how much to save, individuals face a complicated set of choices about how to save. It is challenging to figure out how best to allocate assets across various types of retirement accounts, such as 401(k) plans and the various types of individual retirement accounts. Annuities and other insurance products are complex and require a degree of financial sophistication to understand and successfully navigate. Individuals and households are facing these challenges against a backdrop of stagnant real wage growth and fiscally strained public sector programs. With the aging of

the baby boom generation and rising life expectancy, the number of retirees receiving public support has increased markedly, putting fiscal pressures on the Social Security, Medicare, and Medicaid programs. At the same time, health-care costs for seniors continue to rise. Taken together, demographic changes, gains in longevity, and higher medical costs mean that a large and increasing share of our nation's resources is devoted to supporting the elderly. Absent a dramatic change in policy, the public costs of providing care for seniors will rise. This growth presents additional public sector challenges, which, if unmet, will create uncertainty about how much individuals can reasonably expect to rely on these programs to support them in their retirement years. A founding principle of The Hamilton Project's economic strategy is that individual economic security is a cornerstone of our nation's long-term prosperity. Achieving financial well-being in retirement is an important component of that goal. In that spirit we offer this framing document to bring attention to trends in Americans' financial security and preparedness for retirement. (June 2015).

**7. 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](http://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.

**8. APHORISMS:** After 60, if you do not wake up aching in every joint, you are probably dead.

**9. TODAY IN HISTORY:** In 1950, Israeli airline El Al begins service.

**10. 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.

**11. 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>.

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

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