



**CYPEN & CYPEN**  
**NEWSLETTER**  
**for**  
**FEBRUARY 11, 2016**

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Never Forget September 11, 2001

and

Always Remember May 2, 2011

**1. ARE CALIFORNIA TEACHERS BETTER OFF WITH A PENSION OR A 401(K)?:** The UC Berkeley Center for Labor Research and Education has published a report analyzing whether California teachers are better off with pensions or 401(k)s. Pensions form a significant part of public school teacher compensation, and provide the primary source of retirement security for teachers, many of whom are not included in Social Security. While many private sector

employers have shifted the retirement benefit costs and risks to employees by switching to 401(k) style plans, most public school teachers are still covered by defined benefit pensions, which provide guaranteed retirement income and reward long service. While 401(k) plans have the advantage of portability for a mobile workforce, defined benefit pensions provide greater retirement income security and reduce turnover. Given the role of retirement benefits in meeting both employer goals for workforce retention and employee goals for retirement income security, the study examines the suitability of defined benefit pensions for California teachers compared to alternative retirement benefits. Recent studies have questioned the adequacy and fairness of defined benefit pensions -- including CalSTRS -- based on the fact that a large percentage of new-hire teachers drop out early, and thus do not stay long enough to collect full pension benefits. These studies conclude that an account-based system would be fairer, whether that be a defined contribution plan such as a 401(k) or a cash balance plan. However, while early career turnover is a serious concern with respect to lost investment in training, analyses based primarily on new-hire attrition rates ignore the fact that most classroom teaching positions are not occupied by those who leave after a few years, but by those who stay long term. This study compares CalSTRS pension benefits for California public school teachers to alternative retirement benefits, focusing on the currently active teaching workforce. The study analyzes teacher turnover patterns and projects the final tenure years of service at retirement or separation, for the current teaching workforce using

CalSTRS' actuarial assumptions. The authors then model benefits under alternative plan designs -- an idealized 401(k) plan and a generous cash balance plan that guarantees 7% interest on contributions -- and compare them to the current CalSTRS pension for teachers hired since 2013. Finally, there is analysis of benefit outcomes for the three plans in the context of tenure analysis findings in order to estimate the share of active teachers who are better off in the current defined benefit plan versus alternative retirement plans, and *vice versa*. Overall, the CalSTRS pension benefit structure -- which is designed to reward teachers who stay until at least early retirement age -- is better matched to the needs of the active teaching workforce than 401(k) or cash balance plans. Although early career turnover is high, most of the teachers whom a student will have during their K–12 education journey in California will have served 20 to 30 years or more before the student leaves public education in the state. Thus, the vast majority of the educators currently serving in California public schools can expect to collect pension benefits under CalSTRS that are superior in value and security to what they could receive under an ideal 401(k)-style plan. The CalSTRS pension system also offers significantly higher benefits compared to a generously modeled cash balance plan for a large majority of active teachers. Ultimately, switching to an account-based retirement system, such as a 401(k) or cash balance plan, would sharply reduce the retirement income security of teachers who account for a large majority of educational labor in California. Here are some specific key findings:

- Most classroom teaching in California is performed by long-career teachers who are well-positioned to benefit from a traditional pension.
- For the vast majority of California teachers (six out of seven), the CalSTRS defined benefit pension provides greater, more secure retirement income compared to a 401(k)-style plan.
- Conversely, only one out of seven teachers currently teaching in California schools will accrue less benefit under the CalSTRS defined benefit plan than they would if contributions were deposited into a defined contribution, 401(k)-type plan assuming average investment returns.
- Focusing on new-hire attrition rates is misleading.
- 401(k) and cash balance plans generate their own risks and inequalities in retirement income, decreasing the incentive for early and mid-career teachers to stay, and making it harder for older teachers to retire.

**2. CIVIC GROUPS WILL PAY TO STUDY PENSIONS:** Before making any changes to police and firefighters' retirement benefits, the Palm Beach Town Council will be able to see how other municipalities compensate their public safety workers according to International Foundation of Employee Benefit Plans. Two nonprofit civic groups have offered jointly to pay for a study of the total compensation packages that 22 other regional municipalities provide to their police and firefighters. The committee is looking for ways to boost pension benefits to improve employee retention in the police and fire

departments. The departments have seen a sharp increase in employee turnover since the council, citing long term financial concerns, cut pension benefits in 2012. More than 60% of the employees in the police and fire departments have less than three years' experience. Council decisions to raise the retirement age to 65 and to cut a multiplier used to help determine pension payments were especially unpopular and have led to an exodus to other municipalities. The civic association and police foundation selected the Mercer organization for its expertise with pension benefits and compensation and for its ability to provide an independent review. Mercer will be asked to look at the total compensation -- including pay, vacation and retirement benefits offered to public safety workers in 22 municipalities pinpointed by departing employees in exit interviews with the town. Mercer has been asked to deliver its report by March 3, 2016, so its recommendations can be considered by the committee before the council begins its budget review in April. Increasing benefits will cost money, and the town's retirement investments already have taken a beating in the stock market over the last year, creating a shortfall for the existing program. A debate over a possible tax increase might be around the corner. The council is willing to find a solution that addresses the public safety issue but also works for the taxpayers. Palm Civic Association, Palm Beach Foundation really are "civic."

### **3. CORRECTION TO CBO'S ANALYSIS OF REPLACEMENT**

**RATES FOR SOCIAL SECURITY:** After questions were raised by

outside analysts, Congressional Budget Office identified some errors in one part of its report, CBO's 2015 Long-Term Projections for Social Security: Additional Information, which was released on December 16, 2015. The errors occurred in CBO's calculations of replacement rates -- the ratio of Social Security recipients' benefits for their past earnings. The errors affected no other estimates in the report. A new version of the document, with corrections to Exhibits 10 and 12, has been posted on CBO's website, <https://www.cbo.gov/publication/51047>. In the report, replacement rates were defined to be initial benefits, as a percentage of average late career earnings; for those calculations, earnings consisted of the last five years of earnings that were at least half of a worker's average indexed earnings, adjusted for growth in prices. The estimates reported in December inadvertently included years with earnings below those intended amounts. The corrected version shows substantially lower mean initial replacement rates for retired and disabled workers. For example, the corrected rate for retired workers born in the 1940s is 43%, the value CBO reported in December was 60%. As our readers may know, a CBO provides nonpartisan analysis for the U.S. Congress.

**4. IRS FACT SHEET ON 2015 TAX CHANGES:** Internal Revenue Service has issued a Fact Sheet on 2015 tax changes, which include:

- Most taxpayers will have until Monday, April 18, to file their 2015 returns and pay any taxes due. The reason is because

Emancipation Day, a holiday observed in the District of Columbia, falls this year on Friday, April 15. By law, D.C. holidays impact tax deadlines in the same way federal holidays do. In addition, because of the Patriots' Day holiday observed on Monday, April 18, in Maine and Massachusetts, residents of those states will have until Tuesday, April 19, to file. Regardless of where they live, taxpayers requesting an extension will have until Monday, October 17, 2016, to file.

- The standard mileage rates for the use of a car, van, pickup or parcel truck are 57.5 cents per mile for business miles driven in 2015, up from 56 cents in 2014. For those planning ahead, the 2016 rate, for use on a 2016 return filed next year, is 54 cents per mile. Twenty-three cents per mile driven for medical or moving purposes in 2015, down from 23.5 cents in 2014. The 2016 rate is 19 cents. Fourteen cents per mile driven in service of charitable organizations. This rate is set by law and is unchanged.
- Beginning in 2015, an IRA owner can make only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs he owns. The limit applies by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit. But the IRA owner can continue to make unlimited trustee-to-trustee transfers between IRAs. Before 2015, the one-per-year

limit applied only on an IRA-by-IRA basis, that is, only to rollovers involving the same IRAs. There is a 2015 transition rule that ignores some 2014 distributions. An IRA distribution rolled over to another (or the same) IRA in 2014 does not prevent a 2015 distribution (within the one-year period) from being rolled over provided the 2015 distribution is from an IRA that is different from any IRA involved in the 2014 rollover. FS-2016-8, February 2016.

**5. S&P 1500 PENSION FUNDED STATUS GAINS IN 2015 WIPED OUT BY JANUARY DECLINES:** The estimated aggregate funding level of pension plans sponsored by S&P 1500 companies decreased by 3% to 79% as of January 31, 2016, as a result of negative equity markets and a decrease in rates. As of January 31, 2016, the estimated aggregate deficit of \$472 billion USD increased by \$68 billion as compared to the \$404 billion USD deficit measured at the end of 2015, according to Mercer. The S&P 500 index dropped 5.1% and the MSCI EAFE index dropped 7.3% in January. Typical discount rates for pension plans as measured by the Mercer Yield Curve decreased to 4.13%. In just one month of 2016, we have seen the entire improvement in funded status for 2015 disappear, said Jim Ritchie, a Principal in Mercer's Retirement Business. 2015 may have been the end of the latest bull market, causing a great deal of stress on corporate pension plans. While many plan sponsors have taken steps to de-risk their pension plans, 2016 will be a test on how much risk pension plans still retain. We recommend that plan sponsors have

a sense of urgency to stress test their pension plans against equity losses and adjust their asset allocation strategy accordingly. While many believe interest rates will rise and help improve the funded status of pension plans, the recent action by the Federal Reserve was arguably already priced into long term rates and has in fact not prevented further reduction in yields, as investors make a flight to long term fixed income.

## **6. GLOBAL RETIREMENT ASSETS RELATIVELY FLAT IN 2015:**

Retirement assets in 19 major global pension markets totaled \$35,438 trillion as of December 31, 2015, a 0.5% drop from the previous year, said Willis Towers Watson's annual Global Pension Assets Study.

U.S. assets made up 61.5% of total global assets, while the U.K. and Japan came next at 9% and 7.7%, respectively. Retirement plan assets as a ratio to global GDP totaled 80.3% at the end of 2015, a decrease of 3.9 percentage points from the previous year's ratio of 84.2%. The ratio at the end of 2013 was 83%. Of the 19 countries profiled, the Netherlands had the greatest ratio of assets to GDP at 183.6%, followed by the U.S. at 121.2%, Australia at 119.6%, Switzerland at 118.7% and the U.K. at 111.9%. Countries with the lowest ratios are Spain at 3.3%, India at 4.2% and France at 6.2%.

For the seven largest markets, defined contribution plan assets accounted for 48.4% of the \$32.922 trillion of assets in 2015, up from 46.7% in 2014. The seven largest are the U.S., U.K., Australia, Netherlands, Switzerland, Canada and Japan, which make up 92.9% of the 19 major global pension markets. Australia had the highest

proportion of DC to DB assets, at 87% and 13%, respectively, up from 85% and 15% the year before. The DC/DB proportion in the U.S. was 60% and 40%, up from 58% and 42% the year before. They are the only two countries of the 19 examined with a larger proportion of DC assets than DB. The U.S. DC numbers include individual retirement accounts. During the last 10 years among the seven largest markets, defined contribution plan assets have increased an annualized 7.1%, while defined benefit plan assets have grown only 3.4% annually. The average global asset allocation of the seven largest markets is 44% equities, 29% fixed income, 24% other assets (including real estate and other alternatives) and 3% cash. The previous year's average allocation was 42.3% equities, 30.6% fixed income, 24.8% other assets (including real estate and other alternatives) and 2.3% cash.

**7. MISSED YOUR 2015 RMD? KEEP CALM AND TAKE THESE 3 STEPS:** Did you take your required minimum distribution from your IRA for 2015? Hopefully, the answer is yes, because for most IRA owners and beneficiaries the deadline for taking a 2015 RMD was December 31, 2015 according to irahelp.com. There is an exception. If you reached age 70 ½ in 2015, you still have time. Your deadline for taking your 2015 RMD from your IRA is April 1, 2016. The end of the year can be a busy time. Sometimes things slip through the cracks. If you missed the RMD deadline, statistics show you are not alone. A report released by the Treasury Inspector General for Tax Administration showed a surprisingly high number of IRA owners fail to take their RMDs and recommended that the IRS step up

enforcement. The penalty for missing an RMD is steep. There is a 50% penalty assessed on the amount of the RMD that is not taken by the deadline. For example, if you failed to take your \$6,000 RMD for 2015, you would be subject to a \$3,000 penalty. If less than the full amount of the RMD is not taken, the 50% penalty is assessed on the amount not taken. For example, if your RMD for 2015 was \$6,000 and you took only \$1,000, you would be subject to a 50% penalty on the \$5,000 not taken. Your penalty would be \$2,500. If you missed your RMD, keep calm. The IRS can waive the 50% penalty for good cause. Here are three steps you will need to take to have the penalty waived: (1) take the RMD. To have the 50% penalty waived by the IRS you must correct your error. You must take the RMD amount that was not taken in 2015; (2) file the 2015 IRS Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. When you file this form, you do not have to prepay the penalty, but if the form is filed without payment of the 50% penalty and IRS determines that the penalty is owed, you could owe interest on the penalty payment. Form 5329 must be filed to start the statute of limitations clock; and (3) attach a letter of explanation to Form 5329. The letter should include why the 2015 RMD was missed, the fact that it has now been taken, and that you have taken steps to be sure that future RMDs will be taken as required. After submitting your request, you must wait for the IRS response. The IRS may respond to your waiver requests within a few months. If you have not heard from them in three years, they have granted the waiver. Getting a waiver of the 50% penalty for failing to take your RMD may seem complicated and

time consuming, but it can be worth the effort because many taxpayers have had successful results. If you have questions or need assistance with the process it is always best to contact a knowledgeable financial advisor or tax preparer for advice.

**8. THE FIVE WORST PEOPLE AT A TRAFFIC STOP:** From leoaffairs.com we read five worst people at a traffic stop:

- **People who do not know they are trying to kill me.** There is a saying for someone who might be celebrating a little too hard after a big win: “act like you have been there before”. The timeless saying applies when being pulled over. We have all had that 30 something come to a complete stop in the middle lane of the highway instead of pulling to the right into a place of safety where I do not have to worry about someone making street pizza out of me.
- **People who think they are my boss.** I never thought I would actually hear “my taxes pay your salary,” until that fateful day. Cops also pay taxes which go to pay their own salaries. We will just put this traffic stop on my tab instead of yours. Sign On The X Please, Sir.
- **These Guys....** If I pull you over for running a red light, a suspended registration, a busted headlight, and you are drunk...please do not open your window and say, “what seems to be the problem, Officer?”
- **“Sovereign Citizens.”** There are some people who believe the

earth is flat. There are also some people who believe it is unconstitutional for the state to require them to possess a valid license or registration while operating a motor vehicle. The earth is in fact round and you can pick your vehicle up from the impound lot when you make bond.

- **Name Droppers.** “I know Mayor So-and-So. We will see what he thinks about you pulling me over.” Please tell them I would like a raise and better equipment, while you are at it. Here is your “VIP” ticket to court on the seventh of next month. Please excuse us, we do not yet have a red carpet for this event.

More truth than fiction.

**9. SO YOU THINK YOU KNOW EVERYTHING:** Leonardo Da Vinci invented the scissors.

**10. TODAY IN HISTORY:** In 1966, San Francisco Giant Willie Mays signs highest contract, \$130,000. per year.

**11. 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.

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