



CYPEN & CYPEN
NEWSLETTER
for
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Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. WHY POLITICS HAS NO PLACE ON PENSION BOARDS:

Elected officials, politician-appointed trustees and their low financial expertise exhibited poor returns in private equity, research has found. As reported by Chief Investment Officer, politicians and government-appointed board trustees may not know what is best for pension fund investing -- and may even be a cause of poor returns. Public pension

board composition had a strong impact on the fund's private equity performance. From a study of 210 U.S. public pension funds with more than 13,000 private equity investments from 1990 to 2011, the authors found funds with boards heavily made up of elected officials or members appointed by state representatives underperformed the worst. Specifically, state-appointed board members were linked to the lowest performance, with a 10-percentage point increase in the proportion of such members resulting in about a 0.9 percentage point drop in annual net internal rate of return. And *ex officio* board members followed suit, with a 10-percentage point rise in their representation leading to a drop in annual net IRR of between 0.53 and 0.67 percentage points. The underperformance is related both to investment category allocation and to selection of managers within category. The research revealed funds whose boards housed more state officials and elected plan participants invested more in real estate and fund-of-funds. These poorly governed funds were also strongly correlated with poor investment decisions in private equity including overweighting in small and in-state funds, as well as allocating to inexperienced general partners. Despite associations to low performance and ill decision-making, these state-appointed and state-*ex officio* trustees represented 7.6% to 25.4% of board members of 34 studied pension funds. Trustee background data also showed only 21% of members selected by government executives had asset management experience, and just 10% had any financial experience. Figures dwindled further for elected officials serving on pension boards, with 18% and 10% with asset management and financial

experience, respectively. Read the entire 52-page scholarly report: “Pension Fund Board Composition and Investment Performance: Evidence from Private Equity” at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2754820.

2. SUMMARY OF THE QUARTERLY SURVEY OF PUBLIC

PENSIONS FOR FOURTH QUARTER 2015: For the 100 largest public-employee pension systems in the country, assets (cash and investments) totaled \$3,243.3 billion in the fourth quarter of 2015, increasing 0.9% from the third quarter level of \$3,215.9 billion. This increase in assets is mainly due to positive earnings, as evidenced by a gain of \$63.6 billion in the fourth quarter. Compared to the same quarter in 2014, assets for these major public pension systems decreased 3.0% from \$3,343.6 billion. The major asset categories highlighted in this summary (equities, debt instruments, and cash equivalents) do not reflect all the categories published for the Quarterly Survey of Public Pensions. International securities had a quarter-to-quarter increase of 4.1%, from \$575.1 billion to \$598.7 billion in the fourth quarter of 2015. Conversely, international securities decreased 1.8% year-to-year, from \$609.6 billion to \$598.7 billion. International securities comprised less than a fifth (18.5%) of total cash and investments of major public pension systems for the current quarter. Corporate stocks had a quarter-to-quarter increase of 2.0%, from \$1,154.8 billion to \$1,177.8 billion during the fourth quarter of 2015. However, corporate stocks experienced a year-to-year decrease of 3.4% from \$1,219.1 billion in the fourth quarter of 2014.

Corporate stocks comprised more than a third (36.3%) of the total cash and investments of major public pension systems for the current quarter. Corporate bonds had a quarter-to-quarter decrease of 0.4% from \$414.1 billion to \$412.4 billion in the fourth quarter of 2015. However, corporate bonds increased year-to-year by 2.7% from \$401.5 billion in the fourth quarter of 2014. Corporate bonds comprised about an eighth (12.7%) of the total cash and investments of major public pension systems for the current quarter. Employee contributions had a quarter-to-quarter increase of 30.5%, from \$9.3 billion to \$12.1 billion during the fourth quarter of 2015, and a year-to-year increase of 13.7%, from \$10.6 billion in the fourth quarter of 2014. During the same time periods, government contributions had a quarterly increase of 3.1%, from \$28.8 billion to \$29.7 billion, and a year-to-year increase of 20.1%, from \$24.7 billion in the fourth quarter of 2014. The ratio of government contributions to employee contributions was 2.5 to 1, as government contributions comprised 71.1% of total contributions. Total benefit payments decreased 2.0% to \$63.8 billion, from \$65.1 billion from a quarter ago.

3. SCALIA ABSENCE FELT IN PUBLIC SECTOR UNIONS FEE

CASE: An article in *The Wall Street Journal* reminds us that less than three months ago the Supreme Court appeared ready to dismantle a major source of public sector union power. The case of whether government workers can be required to pay a fee for representation even if they decline to join their labor organization seemed to hinge on Justice Antonin Scalia's stance. And during oral argument on January

16, 2016 he gave court observers the impression that compulsory dues requirements in place in more than 20 states were doomed. But, of course, Scalia suddenly died on February 13, 2016. In a most dramatic consequence of the late justice's absence, the eight remaining justices came out deadlocked in the case, effectively handing public employee unions a huge victory. The decision highlighted the stakes for filling the court's vacancy. The court announced the outcome with a one line opinion: the judgment is affirmed by an equally divided court. The 4-4 split leaves in place a lower court ruling favoring unions in a case brought by nine California teachers and a Christian educators group. The challengers sought to overrule a 1977 precedent permitting unions to levy the charges in states that allow it, arguing the practice violates First Amendment rights to free speech and association. Government unions in more than 20, mostly Democratic-leaning states, rely on the so-called "fair-share" clauses in bargaining agreements as a stable source of support amid a decline in membership in the private sector. *Friedrichs v. California Teachers Association*, Docket No. 14-915 (U.S. March 29, 2016) (*Per Curium*). Nice going, Mitch.

4. BETTER INFORMATION ON INCOME REPLACEMENT RATES NEEDED TO HELP WORKERS PLAN FOR RETIREMENT: United States Government Accountability Office has issued a new report dealing with using a replacement rate for estimating retirement savings needs. Household spending patterns varied by age, with mid-career households (those aged 45-49) spending more than older

households. For example, according to 2013 survey data from the Bureau of Labor Statistics, mid-career households spent an estimated average of around \$58,500, while young retiree households (those aged 65-69) spent about 20% less. While the share of spending was consistent for some categories, other categories had larger variations across age groups. For example, housing expenses comprised the largest share of spending regardless of age, while older households spent more out of pocket on health care than mid-career households. Spending was less variable across age for low-income households compared to other households. For example, there was not a significant difference in average spending between mid-career and young retiree households in the lowest income quartile, compared to an approximately \$20,000 difference for the highest income quartile. These variations in spending patterns have implications for the resources households need to maintain their standard of living in retirement. Researchers and financial industry professionals develop target replacement rates -- the percentage of income to aim for in retirement -- based on certain key factors, including spending, household characteristics, and pre-retirement earnings. GAO's analysis of the literature found that calculating an appropriate replacement rate can be complex. For example, there is debate over whether households that have raised children should target a lower replacement rate than households that have not. In addition, a worker's pre-retirement earnings could be defined as earnings at the end of the worker's career or as average earnings over the course of the career. Despite these complicated considerations, target

replacement rates cited in the articles and reports GAO reviewed typically range between 70 and 85%. Some financial industry professionals told GAO that they develop customized targets that take into account workers' assets and expected spending, while others questioned the usefulness of replacement rates. The information and tools on replacement rates that the Department of Labor provides may be too limited to help workers understand how to use such rates for retirement planning. DOL's Employee Benefits Security Administration's website provides information and tools to help American workers better plan for retirement, including a tool to help workers calculate their retirement income needs as a percentage of preretirement income. While EBSA's materials note that a target replacement rate can vary based on individual circumstances, they do not include specific examples of demographic groups that research indicates can result in higher or lower income replacement needs, or how much a replacement rate might need to be adjusted for those groups or for other individual circumstances. Without additional information, workers may not understand how to adjust target replacement rates when planning for retirement. Further, EBSA's worksheet and online tool for calculating how much to save use a default replacement rate with no opportunity for a user to adjust the rate based on individual circumstances. Without the ability to adjust the replacement rates used in planning tools, workers may over- or under-estimate how much they need to save for retirement. GAO 16-242 (March 2016).

5. MORE WORKERS USE RETIREMENT ACCOUNTS FOR NON-EMERGENCIES:

Besides wreaking havoc among workers and their ability to save money for the future, the Great Recession added at least one other unintended consequence: it turned the tide for workers' loyalty to their current employers. Benefitnews.com says the days of people working for the same employer for 20 to 30 years are gone. The average amount of time workers stay at one job is three to five years. But post-recession, more people are working in contracting settings and are sticking with firms for quite a while. The tenure appears to be getting longer. A recent survey found that employees tend to be more loyal to their employers now, and look to them as their main source of financial information. That trend is what has driven popularity of workplace financial wellness programs in the past five years. Employers realize that their employees need help in managing their money. The survey found that nearly half of all parents have gone into debt purchasing something their kids wanted, and 72% of parents said they do not have sufficient emergency funds to cover at least three months' worth of living expenses. Forty-nine percent said they do not have an emergency fund at all. Retirement savings is another area in which employees fall short. Forty-four percent of parents said they had used retirement savings to fund non-emergencies in the past two years. More than half agreed with the statement: "if I save 6% of my income towards retirement, I will have enough money comfortably to retire at age 65." Wrong again, Monetary Breath: six percent is not going to do it these days, and is certainly less than the standard recommended. Most industry experts

believe that workers need to save 15% of their income annually to achieve retirement readiness at age 65. Parents' knowledge of savings matters was also deficient. Sixty-seven percent of parents said that saving for their child's college education was more important than saving for retirement. Many of them, 44%, have used their retirement savings to fund non-emergencies, like paying off debt, kids' education and day-to-day expenses. In fact, more people tap their retirement for non-emergencies than emergencies. Employers have an opportunity to step up and help employees with some of the guide posts around savings. Employers are much more involved in providing financial education to their workforces now, and employees value that information. Surveyor also questioned children between the ages of 8 and 14 about money. Forty-four percent of children said that they regularly talk about money with their friends. And 47% have loaned money to their friends. One-third of the children surveyed said their parents feel uncomfortable talking about money with them. The ability to talk about money with friends feels like a positive situation; parents should be more proactive in talking about finances with children, even having conversations about it once a week. The more it becomes standard information to talk about, it feels like that is the positive direction in which to go. Sounds right.

6. REVIEW AND ANALYSIS OF SECURITIES CLASS ACTION

SETTLEMENTS: Cornerstone Research has released a report entitled "Securities Class Action Settlements -- 2015 Review and Analysis." Some highlights are

- There were 80 securities class action settlements approved in 2015, representing a 27% rise in the number of settlements over 2014 and the highest number since 2010.
- Total settlement dollars in 2015 increased substantially over the 2014 historic low to \$3 billion and were 9% higher than the average for the prior five years.
- In 2015, there were eight mega-settlements (those greater than or equal to \$100 million), up from just one in 2014.
- The average settlement size climbed from \$17 million in 2014 to \$37.9 million in 2015 (an increase of 123%), while the median settlement amount (representing the typical case) remained relatively flat (\$6.0 million in 2014 and \$6.1 million in 2015).
- Average “estimated damages” rose 151% from 2014. Since “estimated damages,” the simplified damages calculation used in this research, is the most important factor in predicting settlement amounts, this increase contributed to the substantially higher average settlement amounts in 2015.
- Median settlements as a percentage of “estimated damages” decreased to historic low levels in 2015.
- In 2015, 35% of accounting-related cases had a named auditor defendant, representing a 50% increase over the prior 10-year average. Underwriter defendants were named in 76% of cases with Section 11 claims.
- Although the proportion of securities class action settlements involving financial sector firms was lower in 2014 and 2015

compared to prior years, these cases continue to be some of the largest when measured by “estimated damages.” In 2015, 55% of financial sector settlements involved “estimated damages” of greater than \$1 billion.

This report analyzes 1,537 securities class actions filed after passage of the Private Securities Litigation Reform Act of 1995 and settled from 1996 through year-end 2015, and explores a variety of factors that influence settlement outcomes.

7. IMPACT ON EMPLOYEE FINANCIAL STRESS MAY BE HIGHER THAN THOUGHT:

Financial pressures are impeding the job performance of nearly one out of four employees by their own admission, and almost as many employers report substantial losses in productivity as a result. Employee Benefit Adviser says that 24% of American workers say they experience distractions on their jobs due to personal financial issues. Even more worrisome, stress over finances at the workplace affects 60% of younger millennial workers -- those born in the early 1980s through the early 2000s. High earning individuals making \$100,000 a year or more also report experiencing financial stress at work, busting the myth that such problems are only experienced by low income, unskilled employees. Employees who are distracted by financial pressures end up costing companies in several ways, and the impact on business revenue can be quite severe. Heightened levels of anxiety hurt morale and prevent workers from producing at maximum efficiency. Medical expenses and time off for

injuries or illnesses due to financial stress are another major drain on a business's bottom line, as are costs of the various programs that help employees address these issues. Absenteeism due to financial problems is another costly issue. Approximately one out of five workers reports that they have left the job early or missed work altogether in order to attend to personal financial problems. Nearly half of respondents admitted to being overly fatigued, causing distraction and mistakes during working hours. So how big is the impact? Close to one out of four of line supervisors and HR officers report that personal financial concerns of employees have taken a significant toll on production. To try and help remedy this, some 50% of employers have made efforts to provide retirement savings assistance and financial educational programs. Yet, only a meager 6% of employees feel that their employers are providing them with sufficient help effectively to manage their finances. Unfortunately, the trend is clear enough. The number of employed Americans suffering some form of financial stress is large and growing, and is detracting from their job performance and hurting employers' bottom line.

8. MAYOR IN HOT WATER FOR SENDING PICTURE OF HIS

GENITALIA: The Mayor of Hernando, Mississippi, got more than he bargained for when a private sexting photo he sent to a woman ended up being made public. According to leoaffairs.com, Mayor Chip Johnson sent a shower-themed nude photo to a woman he was dating. The Mayor defended his actions as something meant to be between consenting adults that was private. Though Johnson is

currently going through a divorce, he says he trusted the woman to keep the photo a secret. The Mayor insists that the photo has nothing to do with his job as Mayor. This conduct seems to be growing, especially among politicians (does the name Anthony Weiner ring a bell?) By the way, we hear tell that unlawful exposure is a hangin' offense in Mississippi. (Johnson, eh?)

9. SO YOU THINK YOU KNOW EVERYTHING: The sentence: "the quick brown fox jumps over the lazy dog" uses every letter of the alphabet. (We actually did know this one!)

10. TODAY IN HISTORY: In 1902, Texas Oil Company (Texaco) forms.

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.