



CYPEN & CYPEN
NEWSLETTER
for
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Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. PENSION PARTICIPATION, WEALTH, AND INCOME: Center for Retirement Research at Boston College has issued a new white paper entitled “Pension Participation, Wealth, And Income: 1992 - 2010.” Employer-sponsored retirement plans have shifted dramatically in recent decades from defined benefit to defined contribution plans. Although theoretical calculations show that participants in 401(k) and other DC plans who stay the course can accumulate substantial

account balances, many studies have documented how such plans often fall short. This shortfall reflects a failure to participate, inadequate contribution rates, leakages, poor investment choices, and subpar market returns. On the other hand, while DB plans provide generous benefits for workers who spend most of their career with a single employer, the pensions of job-hoppers are eroded by inflation and those who separate prior to vesting receive nothing. Therefore, the net effect of the shift from DB to DC plans on retirement wealth and income is unclear. The white paper uses the Health and Retirement Study to document pension wealth and income for households whose heads were ages 51-56 in 1992, 1998, 2004, and 2010. The first question is whether workers in 2010, when DC plans predominated, had more or less retirement wealth from employer-sponsored plans than their counterparts in 1992, when DB plans predominated. The question is not just the total amount of wealth but also who holds it, so the distribution of retirement wealth by educational quartile is important. Income, however, not wealth is the variable of ultimate interest, and, for any given retirement age, DB plans with actuarially fair annuities provide more income per dollar of wealth than DC plans where annuities must be purchased on the open market. Finally, income levels by themselves tell only part of the story because stable levels of income with rising wages will lead to declining replacement rates. Thus, the analysis covers pension wealth, the distribution of pension wealth, the amount of income produced by DB and DC wealth, and finally the pattern of replacement rates over the period 1992-2010. The remainder of the white paper

proceeds as follows: the second section reviews previous research. The third section discusses the calculation of pension wealth and shows how the levels of wealth have changed over time. It also describes the shifting distribution of pension wealth. The fourth section describes assumptions used to calculate pension income and presents the pattern over time. It also calculates replacement rates and presents those results. The final section concludes with four observations. First, retirement wealth has been steady or declining, depending on whether the starting year is 1992 or 1998. Second, DC wealth is more concentrated in the top quartile than DB wealth, and this concentration will show up in the aggregate wealth measure as the shift from DB to DC evolves. Third, the shift from DB to DC has also caused a reduction in retirement income per dollar of pension wealth because DC participants must purchase an actuarially unfair annuity and annuity rates fell as interest rates dropped. Fourth, even with later retirement, steady pension income combined with rising wages has produced declining replacement rates. Thus, pension income from employer plans has been contracting just as Social Security replacement rates have started to decline due to the increase in the full retirement age. With increases in the Social Security Full Retirement Age (equivalent to a replacement rate cut for those who do not delay retirement), increases in Medicare premiums and out-of-pocket health care costs, and increased longevity, households will require ever larger private pension replacement rates if they are to maintain their standard of living in retirement. The findings show that although retirees will need more from employer-sponsored plans, they

will receive less. Consistent with data from the Current Population Survey and other government surveys, overall participation in employer-sponsored plans has declined. The percentage of households 51-56 with a participant in either a DB or DC plan dropped from 68% in 1992 to 63% in 2010. Overall pension wealth can at best be characterized as “flat” from 1992 to 2010. Mean and median retirement wealth in 2010 was larger than in 1992, but lower than in 1998 and 2004. Moreover, DC wealth is more skewed towards the top quartile than DB wealth. In 2010, the top quartile held 35% of DB wealth, compared to 52% of DC wealth. This pattern is beginning to show up in the total wealth data as DC plans overtake DB plans as a percentage of the total. In terms of pension income, the shift from DB to DC plans, with actuarially unfair annuities and declining interest rates, has resulted in a decline in the income-to-wealth ratio. The decline in the ratio would have been even greater if retirement ages had not been increasing for all participants. Despite later retirement, however, the ratio of projected retirement income to the highest five years of 51-56 earnings has been declining steadily because of rising earnings. The bottom line is that employer-sponsored plans are providing less today than in the past. This outcome could be improved by: 1) making 401(k) plans work better through auto-enrollment, auto-escalation of default contribution rates, and reduced leakages; and 2) expanding coverage to those whose employers do not offer a plan. Without significant changes, however, future retirees will be much more dependent on Social Security than those in the past, which is problematic given the decline in replacement rates due the

increase in the Full Retirement Age and the need to close the 75-year funding gap. To read the entire white paper, visit: http://crr.bc.edu/wp-content/uploads/2016/07/wp_2016-3.pdf. CRR WP 2016-3 (July 2016.)

2. WORLD'S BIGGEST PENSION FUND LOSES \$51 BILLION IN

STOCK ROUT: According to Bloomberg.com, the world's biggest pension fund posted the worst annual performance since the global financial crisis, with losses exacerbated by unfavorable currency moves and a foray into equity markets. Japan's \$1.3 trillion Government Pension Investment Fund lost 3.8% in the year ended March 31, 2015 or 5.3 trillion yen (\$51 billion). That is the biggest drop since the fiscal year ended March 31, 2009. GPIF lost 10.8% on domestic equities and 9.6% on shares in other markets, while Japanese bonds handed the fund a 4.1% gain. The annual loss -- GPIF's first since doubling its allocation to stocks and paring domestic bond holdings in October, 2014 -- came during a volatile stint for markets. Japanese shares sank 13% in the year through March while the yen climbed 6.7% against the dollar, reducing returns from overseas investments. The only asset class to post a profit was local debt, which jumped in value as the Bank of Japan's adoption of negative interest rates sent yields tumbling. In a press briefing in Tokyo after the results were announced, GPIF President said he will reflect on the performance, but that the current portfolio has enough flexibility to adapt to different market conditions and he wants to run the fund steadily. Japan's chief government spokesman said GPIF's

management should not be influenced by short-term moves and there is absolutely no issue with its financing. The fund also disclosed individual stock holdings and the issuers of the bonds it held as of March 2015, the first time it has divulged such detail. GPIF's biggest investments in stocks were Toyota Motor Corp. and Mitsubishi UFJ Financial Group Inc. in Tokyo and Apple Inc. outside Japan. The fund's largest debt holdings included Japanese government bonds and U.S. Treasuries. GPIF plans to announce its holdings as of March this year on November 25, 2016, and is staggering the releases to avoid impacting markets. GPIF held 22% of investments in local stocks at the end of March, and 38% in domestic bonds. Its overseas equity holdings made up 22%, while foreign debt accounted for 13% of its assets. Alternative investments were 0.06% of holdings, up from 0.04% at the end of 2015. GPIF targets allocations of 25% each for Japanese and overseas stocks, 35% for local bonds and 15% for offshore debt. Almost 80% of GPIF's holdings were passive investments, according to the statement. While GPIF's losses can be mostly attributed to rocky markets and an index-hugging investment approach, its peer in Canada has done better. The \$212 billion Canada Pension Plan Investment Board had a 3.4% return for the year ended March, with its biggest gain coming from private emerging-market equity investments and real estate.

3. CELEBRATING SIXTY YEARS OF SOCIAL SECURITY

DISABILITY INSURANCE: When President Roosevelt signed the Social Security Act in 1935 he saw it as an innovative way to provide

economic security for American workers. His advisers also envisioned disability insurance as part of the program, but it was 20 years later when it became a reality. Today SSA celebrates this important milestone: 60 years ago, the Social Security Amendments of 1956 established disability insurance as part of Social Security. In the years since then, the disability program has adapted to keep pace with our changing world. For 60 years, Social Security has protected workers and their families in the event of a severe disability. The disability program provides a critical lifeline to workers and families who lose their income due to the onset of severe, long-term disabilities. Today, about nine million disabled workers and two million of their dependents receive disability benefits from Social Security. Social Security is our nation's most effective poverty prevention program, and disability insurance is a key piece of that. Although the benefits are modest (less than \$1,200 per month on average), these payments are the main source of income for most people who receive them. Among disabled workers, 4 out of 5 beneficiaries rely on these benefits for at least half of their income; for more than a third of beneficiaries, it is their only source of income. Social Security disability benefits lift 3 million people out of poverty each year. To commemorate this milestone, SSA will host a series of articles about the Social Security disability program on its blog in the coming months. SSA will hear from beneficiaries, historians, stakeholders, and disability experts as they reflect on the program's history and importance. As the SSA celebrates a very successful first 60 years of the Social Security Disability Insurance program, it looks forward to

the next 60 and beyond as it continues to protect workers and their families. Whether at birth or in old age, upon the death of a loved one, or in case of disability, Social Security is with you through life's journey!

4. LOW INTEREST RATES A GROWING THREAT TO SOCIAL SECURITY: Record-low yields on U.S. Treasury's endanger the long-run solvency of Social Security and the future retirement benefits for younger generations of Americans, according to marketwatch.com. Newer Treasury bonds held by the trust fund have been earning less for years, the consequence of sluggish economic growth and persistently low interest rates. The Federal Reserve has kept its benchmark short-term rate at or near zero for more than seven years in an effort to stimulate the economy. Even with the Fed's extended easy-money approach, the U.S. economy has not grown fast enough to generate the necessary tax income to help fund all its responsibilities, including Social Security for current and future retirees. Unless changes are made, the lifeline for millions of retirees and disabled persons would not be funded for Generation Xers when they retire in the 2030s, according to a recent report by the custodians of the Social Security system. That generation was born from the mid-1960s to the mid-1970s. As a fix, economists have suggested delaying the retirement age and raising the cap on payroll taxes. Those and other proposals have not gotten very far, however. Something will have to be done soon, experts warn. Mounting payments of benefits due to an aging population and longer life

expectancy, coupled with a lackluster economic recovery since 2010, would soon start draining the Social Security trust fund faster than it can be replenished. By 2034, Social Security's \$2.9 trillion reserves could be depleted. One big problem: shrinking investment income. New investments purchased by the trust funds have been earning less than 3% annually since 2009. Yields have fallen every year from 5.3% in 2007 to 3.4% in 2015. What's more, the trust fund only invests in U.S. Treasury's whose yields have been suppressed by tepid economic growth and unusually strong demand by Americans and foreigners alike looking for safe investments. Interest rates fall on Treasury's when demand for them increases. The benchmark 10-year Treasury yields an all-time low of 1.51%, compared with about 4% before the Great Recession and 6.8% 20 years ago. Low interest rates are not the only issue. There is fewer and fewer workers earning enough money and paying enough in taxes to support a higher number of retirees. Last year, 2.8 workers paid for one retiree's benefits, down from 3.3 in 2007. The ratio is expected to slide to 2.2 in 20 years. If that continues benefit payouts may soon exceed the tax income that supports the system. Some experts support elimination of the cap on taxable wages as one approach to slow the Social Security drain. Getting rid of the cap would reverse the decline in the percentage income that the wealthy pay into Social Security. In 1983, for example, only about 10% of personal income was shield from Social Security taxes. By 2014 it had gone up to 17%. High earners only pay Social Security taxes on the first \$118,500 of income, but their wages have been rising notably faster compared to other

Americans. Ultimately, the best solution is to find a way to restore U.S. growth back to historic levels. The economy has expanded by an average of 2% a year since 2010, well below the nation's long-run 3.3% average. So far the search for an answer has been elusive.

5. INITIATIVE TO END PENSION ABUSE SIGNED INTO LAW IN CHICAGO: Between 2010 and 2014, eleven of Illinois' fifteen major government pension funds made \$2.2 million in payments to more than 1,000 dead people. State Senator Tom Cullerton's initiative to eliminate government waste, House Bill 6030, was recently signed into law, which now requires Chicago state pension funds to develop and implement a process to identify deceased pension recipients each month. Retirement systems do not know a definite amount of pension payments made to deceased annuitants because each pension fund tracks death-related overpayments differently. This new law will give Chicago state pension funds until January 1, 2017, to implement a process to identify deceased recipients at least once a month. The process can include using a third-party company, Social Security Administration data or other available data, as well as any other method that is commonly used by other state retirement systems. With this new law, Illinois has taken a strong step toward eliminating abuse and reducing fraud. By requiring state funds to regularly identify pension recipients who have passed, the law could ultimately result in saving millions of dollars for Illinois woefully underfunded retirement systems. The law goes into effect immediately.

6. IRS WARNS TAXPAYERS OF SUMMER SURGE IN AUTOMATED PHONE SCAM CALLS; REQUESTS FOR FAKE TAX PAYMENTS USING ITUNES GIFT CARDS:

The Internal Revenue Service has warned taxpayers to stay vigilant against an increase of IRS impersonation scams in the form of automated calls and new tactics from scammers demanding tax payments on iTunes and other gift cards. The IRS has seen an increase in “robo-calls” where scammers leave urgent callback requests through the phone telling taxpayers to call back to settle their “tax bill.” These fake calls generally claim to be the last warning before legal action is taken. Once the victim calls back, the scammers may threaten to arrest, deport or revoke the driver’s license of the victim if they do not agree to pay. “It used to be that most of these bogus calls would come from a live-person. Scammers are evolving and using more and more automated calls in an effort to reach the largest number of victims possible,” said IRS Commissioner John Koskinen. “Taxpayers should remain alert for this summer surge of phone scams, and watch for clear warning signs as these scammers change tactics.” In the latest trend, IRS impersonators are demanding payments on iTunes and other gift cards. The IRS reminds taxpayers that any request to settle a tax bill by putting money on any form of gift card is a clear indication of a scam.

Some examples of the varied tactics seen this year are:

- Demanding payment for a “Federal Student Tax”-- IR-2016-81;

- Demanding immediate tax payment for taxes owed on an iTunes or other type of gift card;
- Soliciting W-2 information from payroll and human resources professionals -- IR-2016-34;
- “Verifying” tax return information over the phone -- IR-2016-40; and
- Pretending to be from the tax preparation industry -- IR-2016-28.

Since these bogus calls can take many forms and scammers are constantly changing their strategies, knowing the telltale signs is the best way to avoid becoming a victim. Remember the IRS **Will Never**:

- Call to demand immediate payment over the phone, nor will the agency call about taxes owed without first having mailed you a bill.
- Threaten to immediately bring in local police or other law-enforcement groups to have you arrested for not paying.
- Demand that you pay taxes without giving you the opportunity to question or appeal the amount they say you owe.
- Require you to use a specific payment method for your taxes, such as a prepaid debit card, gift card or wire transfer.
- Ask for credit or debit card numbers over the phone.

If you get a phone call from someone claiming to be from the IRS and asking for money and you don't owe taxes, here's what you should do:

- Do not give out any information. Hang up immediately.
- Contact TIGTA to report the call. Use their “IRS Impersonation Scam Reporting” web page or call 800-366-4484.
- Report it to the Federal Trade Commission. Use the “FTC Complaint Assistant” on FTC.gov. Please add “IRS Telephone Scam” in the notes.
- If you think you might owe taxes, call the IRS directly at 800-829-1040.

IR-2016-99 (August 2, 2016.)

7. SIGNS TO GET YOU THROUGH THE DAY: My reality check bounced.

8. AGING GRACEFULLY: Even duct tape cannot fix stupid... but it can muffle the sound!

9. TODAY IN HISTORY: In 1884, the Statue of Liberty was presented to the U.S. in Paris.

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.