



CYPEN & CYPEN
NEWSLETTER
for
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Stephen H. Cypen, Esq., Editor

Never Forget September 11, 2001

and

Always Remember May 2, 2011

1. M.I.T., N.Y.U. AND YALE ARE SUED OVER RETIREMENT PLAN

FEES: Three prominent universities were sued, accused of allowing their employees to be charged excessive fees on their retirement savings according to nytimes.com. The universities -- the Massachusetts Institute of Technology, New York University and Yale -- each have retirement plans holding more than \$3 billion in assets

and are being individually sued by a number of their employees in cases seeking class-action status. The lawyer representing the three groups of plaintiffs, Jerome J. Schlichter, is a pioneer in retirement plan litigation. Over the last decade, he has filed more than 20 lawsuits on behalf of workers in 401(k) retirement plans and has been widely credited with lowering plan fees across corporate America. With the suits filed in federal courts, the focus has turned to a lesser-known corner of the retirement savings market, 403(b) plans, which are named for a section of the tax code. The accounts are similar to 401(k) plans, but are offered by public schools and nonprofit institutions like universities and hospitals. The complaints allege that the universities, as the plan sponsors, failed to monitor excessive fees paid to administer the plans and did not replace more expensive, poor-performing investments with cheaper ones. Had the plans eliminated their long lists of investment options and used their bargaining power to cut costs, the complaints argue, participants could have collectively saved tens of millions of dollars. "It is important for retirees and employees of universities to have the same rights and ability to build their retirement assets as employees of for-profit companies," said Schlichter, "they should not be penalized." In a statement, New York University said that it took the welfare of its faculty and employees seriously, including a dignified retirement. "The retirement plans offered to them are chosen and administered carefully and prudently. We will litigate this case vigorously and expect to prevail," said John Beckman, a university spokesman. A spokeswoman for M.I.T. said it did not comment on pending litigation,

while Yale said it was “cautious and careful” in administering its plans and would defend itself vigorously. More attention is being paid to investment costs shouldered by American workers, who are less likely today to have pension plans. With the strong support of the Obama administration, the Labor Department introduced new rules in April to strengthen investor protections, requiring a broader group of financial professionals to act in customers’ best interest when handling their retirement money. The aim is to reduce conflicts of interest and the fees consumers pay. Even modest reductions in costs can have a significant effect on retirees’ savings. An oft-cited example from the Labor Department: Paying one percentage point more in fees over a 35-year career -- say 1.5% instead of 0.5% -- could leave a worker with 28% less at retirement. An account with \$25,000 -- and no further contributions for those 35 years -- would rise to only \$163,000 instead of \$227,000, at an annual rate of 7%. Schlichter said the three universities’ plans were targeted because more people were asking questions about their retirement accounts and “these involve clear breaches of the law.” The complaint against N.Y.U., which involves two 403(b) plans covering faculty, research administration and the medical school -- centers largely on costs. The complaint said that participants were offered too many investment choices (there were more than 100 options for faculty), and that many of them were too expensive. The suit, filed in Federal District Court for the Southern District of New York, singles out several investments, including the TIAA Traditional Annuity, which it said has severe restrictions and penalties for withdrawal, as well as variable annuities that have

several layers of fees and have historically underperformed. A spokesman for TIAA said it offered high-quality plans and low-cost investments that provide lifetime income. The suit also argues that even the cheapest funds offered could have been provided for less, given the enormous size and bargaining power of the faculty and medical school plans, which together held \$4.2 billion in assets for more than 24,000 participants at the end of 2014. The complaint alleges that the university did not use its negotiating powers to select a single low-cost record keeper for administrative tasks such as sending statements to employees. It said it also overpaid for these services for many years. The issues concerning Yale's 403(b) retirement plan -- which held nearly \$3.6 billion in assets in the spring of 2014 -- follow a similar pattern: multiple record keepers with excessive fees, costing participants millions of dollars over the last six years; too many investments of the same style; and the use of higher-cost funds instead of identical but lower-priced ones. That case was filed in Federal District Court in Connecticut. Yale eventually consolidated to one provider, TIAA, in April 2015, and swapped in some lower-cost investments, but the suit claims that the changes did not go far enough to fully protect the interests of its employees. Mr. Schlichter said participants were still burdened with sorting through more than 100 options, many of which were too expensive. The complaints lodged against M.I.T.'s retirement plan (unusually, it is a 401(k) like those used by corporations) are similar but with a twist. The suit alleges that the university, because of its longstanding relationship with nearby Fidelity, did not conduct a thorough search for

a plan provider, which might have provided better service for less. The retirement plan offered more than 340 investment options; including 180 Fidelity funds; until July 2015, when M.I.T. reduced the lineup to 37 options but still retained Fidelity as the record keeper. The complaint said that Fidelity had donated “hundreds of thousands of dollars” to M.I.T., while Abigail Johnson, Fidelity’s chief executive, has served as a member of M.I.T.’s board of trustees, giving her influence over the institution’s decision-making. Had the plan reduced its options to those on the menu it adopted last year, “participants would have saved over \$8 million in fees in 2014 alone, and many millions more since 2010,” according to the complaint, filed in Federal District Court in Massachusetts. M.I.T. recognized that the plan structure was inefficient, the filing said, since that was part of the reason it said it made the changes. But even after the overhaul, the suit alleges, investment costs could be further reduced. Fidelity, which noted that it was not a defendant in the case, declined to comment.

2. MILLENNIALS ARE ANXIOUS ABOUT RETIREMENT -- BUT NOT DOING MUCH ABOUT IT: Young workers today probably cannot even think about retiring for 40 or 50 years. Longer lives and the prospect of weaker investment returns mean millennials will probably have to save more money, over a longer period of time, than their parents and grandparents. And the earlier they start saving, the easier it will be to accumulate a nice nest egg according to bloomberg.com. It is not easy to sacrifice now for something that will not happen until the 2060s. When millennials are asked, they say

retirement is a top priority. In a recent Charles Schwab survey, retirement was by far the first concern of all age groups. Millennials even put saving for retirement well ahead of student loans, credit card debt, and job security. But if young workers are this worried about retirement, why are they not doing something about it? It looks like they need a nudge to make the right decisions. That is just one takeaway from data T. Rowe Price Retirement Plan Services shared that offers a window on how seriously millennials -- and other generations -- are taking retirement savings. The company runs 401(k)-style plans for almost 1.9 million people. Just getting started, filling out the paperwork to enroll in an employer's retirement plan is an obstacle. When left to their own devices, just 30% of young workers get around to signing themselves up for their 401(k) plans. More than half of workers in their 30s, 40s, 50s, and early 60s voluntarily take this step. Many companies have started automatically signing up workers for 401(k)s. Employees can decline to participate, but the idea is that very few will bother. Among 20-something workers, 84% go along with being auto-enrolled in a 40(k) plan. Younger workers also contribute a smaller percentage of their salaries to T. Rowe Price retirement plans than older workers do. This makes some sense. Workers who start saving early do not need to save as much as older workers who are playing catch-up. Younger workers, who are typically paid less than their elders, often have a harder time finding money to put away, most experts recommend devoting 10% or 15% of your pay to retirement, including employer contributions. The average young worker is less than halfway there. In some areas,

millennials are making smarter decisions than older savers. The survey For example, workers under 40 are far more likely to be using Roth 401(k) retirement accounts, according to T. Rowe Price's data. Roth accounts take after-tax money, so they do not provide the same immediate tax break as traditional accounts, which take pretax money. But investment gains in a Roth are never taxed, while retirees must pay income taxes on withdrawals from traditional 401(k) and individual retirement accounts. The benefits of Roth accounts are clearest for younger workers, though recent research suggests all workers can benefit from a mix of Roth and traditional assets. Only 6.7% of all worker contributions went to Roth accounts last year, up 43% in just two years. Employees in their 20s make 8.1% of contributions to Roth options. Millennials are less and less likely to raid their 401(k) accounts for today's needs. Workers in their 20s are half as likely as all employees to borrow money from their 401(k). While workers over 40 have taken out more 401(k) loans over the past two years, young workers are borrowing less often. Young workers are often tempted to cash out small 401(k) balances when they hop from job to job, even though these early withdrawals come with a 10% penalty. But more and more workers are going through the hassle of rolling these balances over into new 401(k)s or IRAs. The share of 20-something participants cashing out their 401(k) is down 10% over the past two years.

3. DO NOT GET FANCY: RETIREMENT CONVERSATIONS

SHOULD NOT OVERWHELM CLIENTS: We are all familiar with the

200-page books handed to clients in annual meetings describing Monte Carlo simulations and other fancy statistics according to onwallstreet.com. In the retirement business, advisors tend to make things complicated. The problem is that among the variables of returns, inflation and multitudes of economic scenarios, clients often lose track of their goals. Why? Because this outdated style of communication does not address a client's biggest need: understanding. Overwhelmed, the client tosses the book into a drawer, never to be touched again. Therefore, advisors need to simplify. And no place is this more necessary than in creating a specific, long-term numeric goal for clients' retirement. Far too many people save for retirement aimlessly, amassing an undetermined vault of retirement funds. Although this could lead to a good outcome as clients can never save too much for retirement more often it leaves savers constantly wondering if they are on track. An adviser's job is not just to address clients' financial needs for retirement in the most tax-advantaged way but also to provide peace of mind along the journey. Many clients will get nervous about the market at some point, so having a number will help keep them focused and lead to better conversations. Start by determining cash flow needs in excess of Social Security and pension, the latter of which we see less every day. Find the asset level the client needs to reach in order to switch to an appropriate dividend strategy, from where it can be hedged against inflation. From this number, create mini-goals in today's dollars that can be revisited annually. For instance, advisors might recommend a goal of \$2 million if the client needs \$80,000 annually in dividends. If

the client says \$80,000 is not enough, then adjust that \$2 million goal. There are no questions as to when a client is able to retire, for that time is determined when a number is reached. Basing a discussion on numbers is also important when talking about risk. When the market dipped 20% this year, many clients may have not understood what that meant to their portfolios. However, if they had \$500,000 and just lost \$100,000, that would make most clients sick. The actual dollar amounts affect clients' reactions to down markets, so use it when discussing hedging. An obvious truth in life is that things change, not the least of which are clients' needs. Make clear that the goal number is based on projected needs, and it is not set in stone. From there, have an open conversation that is based on real, understandable goals. It is simple as that.

4. ARE SOCIAL SECURITY BENEFITS FOR PUBLIC SERVICE SECTOR EMPLOYEES AT RISK?: In a recent article from onwallstreet.com, employees who work in the public sector may be in for a rude surprise when they apply for Social Security benefits: their assumed benefits could be significantly less than anticipated. If an employee's earning history includes income from payroll-tax paying private sector jobs, as well as a salary from public sector a perceived conflict may arise. As a result, planners need to help their clients understand, anticipate and plan around these possible benefit surprises. Two provisions cover these situations: The Windfall Elimination Provision and the Government Pension Offset. The WEP applies when the worker is a public sector employee, the GPO when a

spouse claiming spousal benefits is a public sector worker. More than one million beneficiaries, including state or local government employees such as police, firefighter or administrative staff, are affected by the WEP, according to the Congressional Research Service. Almost 30% of public educators are not covered by Social Security. Adding to the confusion, the statements provided by the Social Security Administration project future benefits but may not account for any reduction due to public sector earnings. Public sector workers often do not pay Social Security payroll tax, since their employer provides their own retirement benefit or pension. This decreases lifetime Social Security taxed income with the effect of pushing a higher-wage earner with a lower replacement rate into a lower-wage earner income level, with a higher replacement producing a perceived windfall. However, if a worker has always paid Social Security payroll tax on all earnings the WEP does not apply and there is no reduction in benefits. WEP may reduce benefits if the worker had either of two types of public-sector retirement benefits: a pension or a lump-sum payment. Pensions are a more common option. In general, Social Security benefits are based on average indexed monthly earnings adjusted for inflation (AIME). AIME is multiplied by three replacement rates -- 90%, 32% and 15% -- to arrive at the actual monthly benefit. The WEP reduces benefits by ratcheting the 90% factor down to as low as 40%. The amount that the 90% factor is reduced depends on the total number of years during which the worker had substantial Social Security taxable earnings. If the worker had 30 years or more of substantial Social Security earnings, there is

no WEP reduction to benefits. If there are less than 30 years of substantial earnings, the 90% factor is decreased by 5% for each year. For example, only 25 years of substantial earning would decrease the 90% factor to 65%. The lowest this adjustment can go is down to 40% when there are only 20 years of substantial earnings. Another example would be, a base benefit of \$1730 would be reduced to \$1302 if a worker only had 20 years of substantial earnings, or \$1516 if they had 25 years. The precise definition of substantial earnings is critical -- and they are published annually by the SSA. They range from \$900 in 1937, to \$22,050 in 2016. Anything less than these amounts, and the year does not qualify as one with substantial earnings. There are two important constraints on WEP reductions. First, there is an absolute maximum reduction depending upon years of substantial earnings. The maximum reductions for 2016 range from \$428 per month (for 20 years substantial earnings), to \$43 per month (29 years). No matter what actual value is generated by calculations, benefits will never be reduced more than these amounts. The reduction is also limited for workers with smaller pensions. Their WEP reduction cannot be more than one half of a public sector monthly pension. WEP reductions can affect both spouse and dependents. Normal spousal benefits are between 35% and 50% of the worker's full retirement age benefit including any WEP reductions. A \$400 per month WEP reduction for a worker would translate into a \$140 to \$200 (35%-50% of \$400) reduction for a spousal benefit depending on when the spouse claimed the benefit. Dependent benefits of 50% are similarly reduced as are the total family benefit maximums of 150-

188%. Survivor benefits are, however, exempt from the Windfall Elimination Provisions.

5. CALPERS DOUBLES LIMITS FOR REAL ASSETS STAFF TO

MAKE DISCRETIONARY INVESTMENTS: The CalPERS investment committee approved doubling the limits that top staff can make in real estate and other real asset investments without seeking approval of the investment committee in a piece reported by pionline.com. The new limits for the \$31.8 billion asset class allows Paul Mouchakkaa, managing director, real assets, to make individual real estate investments up to \$3 billion, up from \$1.5 billion, and Chief Investment Officer Theodore Eliopoulos to make real estate investments up to \$6 billion, up from \$3 billion. There is a combined \$10 billion limit that both men can invest on a yearly basis in real estate without investment committee approval, up from \$7 billion. It includes investments with real estate managers as well as direct investments. Upon questioning from investment committee members, Mr. Mouchakkaa said the new limits were needed because of intense competition from other pension plans over larger core real estate deals. Waiting for investment board approval could risk losing a potential deal, he said. Infrastructure investments, also part of the real asset class, will also have new limits. Mr. Mouchakkaa will be able to invest up to \$1 billion, up from \$500 million, and Mr. Eliopoulos can invest up to \$2 billion, up from \$1 billion, without investment committee approval. Total infrastructure investments on a yearly basis for the \$303.3 billion California Public Employees' Retirement System,

Sacramento, now will have a limit of \$3 billion, up from \$2 billion.

6. SIGNS TO GET YOU THROUGH THE DAY: The first five days after the weekend are the hardest.

7. AGING GRACEFULLY: Of course I talk to myself, sometimes I need expert advice.

8. TODAY IN HISTORY: In 1930, Eastern Airlines begins passenger service.

9. 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.

10. 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>.

11. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.