



**CYPEN & CYPEN**  
**NEWSLETTER**  
**for**  
**OCTOBER 20, 2016**

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Never Forget September 11, 2001  
and  
Always Remember May 2, 2011

**1. UNION APPEAL FOCUSES ATTENTION ON PENSION**

**PRECEDENT:** A decision by four Marin County public-employee associations to appeal a pension-related case to the California Supreme Court could ultimately determine whether localities have the tools needed to rein in escalating pension debt says [calwatchdog.com](http://calwatchdog.com). At issue is how far officials can go to reduce some benefits for current employees after a state appeals court has chipped away at a legal “rule” long favored by

the state's unions. In August, a California appeals court ruled against the Marin County Employees' Association in its case challenging a 2012 state law reining in pension-spiking abuses – *i.e.*, those various end-of-career enhancements (unused leave, bonuses, *etc.*) that public employees use to gin up their final salary and their lifetime retirement pay. One of the few areas of widespread agreement at the Capitol on public-employee pensions involves spiking. Governor Jerry Brown signed into law the Public Employees' Pension Reform Act of 2013, known as PEPRRA, to reduce escalating pension liabilities. Most of its provisions applied to new hires only. The governor also signed related legislation, Assembly Bill 187[3]. Its goal was to “exclude from the definition of compensation earnable any compensation determined ... to have been paid to enhance a member's retirement benefit.” This limitation on pension spiking was implemented by the Marin County Employees' Retirement Association to help the county reduce its pension debt. As the court explained “reaction to the change in policy was almost immediate.” Five public-employee associations filed suit, claiming that a ban on these spiking conditions reduced promised levels of pay to their members. They argued this was an impairment of their “vested rights.” Vesting confers ownership rights. Even though the dollars at issue are relatively minimal, the case has become a major flashpoint. California courts have long abided by something known as the “California Rule.” It is not a law or even a rule, actually. It refers to a series of court rulings concluding that once a pension benefit is granted to public employees by a legislative body (board of supervisors, city council, state legislature), it can never be reduced -- even going forward. In the private sector, for

instance, courts allow employers to reduce pension benefits, starting tomorrow. Employees could be paid everything promised to the point of the benefit change, but they can have certain benefits removed or reduced in the future. That is seen as reasonable given they have not earned them yet. It is different in the public sector. In California (and a number of other states that follow a similar rule), these benefits can never be reduced. The problem, from a public-finance point of view, is that reducing benefits for new hires only will not address the bulk of the debt problem until those employees start retiring in 25 or 30 years. Fixing the current debt problem requires dealing with current employees. Ironically, almost all of the benefit increases public agencies have granted to union members since the 1999 passage of Senate Bill 400[8] have been done “retroactively.” In other words, the courts have allowed public agencies to give a boost in pensions to public employees for years they previously have worked -- but they will not allow those same agencies to reduce future benefits for years that have yet to be worked. This is politically controversial, but there is little debate that such a rule has been followed by the courts. “Public employees earn a vested right to their pension benefits immediately upon acceptance of employment and ... such benefits cannot be reduced without a comparable advantage being provided,” according to the plaintiffs, as quoted in the appeals court decision. “A corollary of this approach is that public employees are also entitled to any increase in benefits conferred during their employment, beyond the benefit in place when they began.” In this view, compensation is a one-way ratchet. This understanding has largely undermined every major reform proposed in California. For instance, the

courts gutted the city of San Jose's voter-approved 2012 pension-reform initiative because it rolled back future benefits for current employees. And the "California Rule" has been the obstacle that has stopped reformers from coming up with other similar approaches. In this case, Justice James Richman ruled, "(W)hile a public employee does have a "vested right" to a pension, that right is only to a "reasonable" pension -- not an immutable entitlement to the most optimal formula of calculating that pension. And the Legislature may, prior to the employee's retirement, alter the formula, thereby reducing the anticipated pension. So long as the Legislature's modifications do not deprive the employee of a "reasonable" pension, there is no constitutional violation. Here, the Legislature did not forbid the employer from providing the specified items to an employee as compensation, only the purely prospective inclusion of those items in the computation of the employee's pension." The judge pointed to conclusions from California's watchdog agency, the Little Hoover Commission, pointing to uncontrollable unfunded pension liabilities. As the commission explained, "To provide immediate savings of the scope needed, state and local governments must have the flexibility to alter future, unaccrued retirement benefits for current workers." The commission pointed to spiking as a particular problem. This report, he wrote, is part of what motivated the state Legislature and governor to implement reform. Furthermore, the judge pointed to previous cases acknowledging that government entities have the right to "make reasonable modifications and changes in the pensions system "to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent

policy.” This echoes what myriad pension reformers have argued: agencies are not stuck watching their systems go over the cliff. They have the right and duty to make adjustments to assure their future solvency. If the California Supreme Court sides with the unions, then local governments will have fewer options left to gain control of their pension debts. If the court agrees with Judge Richman, then pension reform could be a brand new ballgame -- although it is unclear whether the court might toss the California Rule entirely or simply allow localities to change some of the benefits within the framework of that rule. The court has 60 days to decide whether to consider the matter, according to reports. Unions and reformers will no doubt be watching the court’s decision closely.

**2. COST-OF-LIVING ADJUSTMENTS:** The National Association of State Retirement Administrators has issued a new brief “*Cost-of-Living Adjustments.*” Most state and local governments provide a COLA for the purpose of offsetting or reducing the effects of inflation, which erodes the purchasing power of retirement income. Using two hypothetical inflation rates, after 20 years, the real (inflation-adjusted) pension benefit in this example of \$25,000 falls to \$16,690 (67% of its original value) or \$13,595 (54% of its original value), depending upon the actual rate of inflation used. Such depreciation can affect the sufficiency of retirement benefits, particularly for those who are unable to supplement their income due to disability or advanced age. Social Security beneficiaries receive an annual COLA to maintain recipients’ purchasing power. Similarly, most state and local governments provide an inflation adjustment to their

retirees' pension benefits. This is particularly important for those public employees -- including nearly half of public school teachers and most public safety workers -- who do not participate in Social Security. Unlike Social Security, however, state and local retirement systems typically pre-fund the cost of a COLA over the working life of an employee to be distributed annually over the course of his or her retired lifetime. The way in which public pension COLAs are calculated and approved varies considerably. In general, COLA types and features are differentiated in the following ways:

- **Automatic vs. Ad hoc.** An overarching distinction among COLAs is whether they are provided automatically or on an ad hoc basis. An ad hoc COLA requires a governing body to actively approve a postretirement benefit increase. By contrast, an automatic COLA occurs without action, and is typically predetermined by a set rate or formula. In some cases, ad hoc COLAs are contingent on other factors, such as a maximum unfunded liability amortization period.
- **Simple vs. Compound.** Another distinction between COLA types is whether the increase is applied in a simple or compound manner. Under a simple COLA arrangement, each year's benefit increase is calculated based upon the employee's original benefit at the time of his or her retirement. Under a compound COLA arrangement the annual benefit increase is calculated based upon the original benefit as well as any prior benefit increases. Some COLAs contain both features, *i.e.*, they may be "simple" until the retiree reaches a certain age or year retired, at which point COLA

benefits are calculated using a compound method.

- **Inflation-based.** Many state and local governments provide a post-retirement COLA based on a consumer price index, which is a measure of inflation. Most provisions like this restrict the size of the adjustment, such as by “one-half of the CPI” and/or “not to exceed three percent.” The most recognized CPI measures are calculated and published by the U.S. Bureau of Labor Statistics, and the CPI measures used by most public pension plans are either the CPI-U (based on all urban consumers) and the CPI-W (urban wage earners and clerical workers). Some states use state-or region-specific inflation measures to determine the amount of the COLA.
- **Some public pension plans tie their COLA to the plan’s funding level or investment performance.** In one statewide system, for example, the COLA is a range tied to CPI based on the funding level of the plan. Annuitants with another state system receive a permanent benefit increase tied to their length of service when the fund’s actuarial investment return exceeds the assumed rate of investment return.
- **Delayed-onset or Minimum Age.** Another characteristic contained in some automatic COLAs is to delay its onset, either by a given number of years or until attainment of a designated age. A COLA may also take on any of the characteristics stated above and will become available to a retiree once he or she meets the designated waiting period or age requirements.
- **Limited Benefit Basis.** Some retirement systems award a COLA calculated on a portion of a retiree’s annual benefit, rather than the

entire amount. For example, one system provides a COLA of three percent applied to only the first \$18,000 of benefit. In such cases, the COLA can also be tied to an external indicator, such as CPI, and factors such as delayed onset may also be present.

- **Self-funded Annuity Option.** Some state retirement plans offer post-retirement benefit increases through an elective process known as a self-funded annuity account. Under this design a member effectively self-funds his or her COLA by choosing to receive a lower monthly benefit in exchange for a fixed rate COLA to be paid annually upon retirement.
- **Reserve Account.** Other public retirement systems pay COLAs from pre-funded reserve account. This is a variation on the COLA tied to investment performance since the reserve account is funded with excess investment earnings. Under this scenario a COLA is provided from the funds set aside in the reserve account. Sometimes there is a stipulation attached that the fund itself must reach a certain size for any COLA to be granted in a given year.
- **COLA Costs.** The cost of a COLA predictably depends on the characteristics of the COLA benefit. Such factors as its size; the portion of the benefit to which the COLA applies; whether or not the COLA is paid annually or sporadically; whether the adjustment is simple or compounded, and other features, all affect its cost. COLAs for some employees of local governments who participate in statewide systems are discretionary based on the decision of individual local government. COLA of one-half of an assumed CPI of three percent, compounded, will add 11% to the cost of the

retirement benefit. An automatic COLA of three percent, compounded, is estimated to add 26% to the cost of the benefit.

The Governmental Accounting Standards Board (GASB) requires public pension plans to disclose assumptions regarding COLAs, including whether the COLA is automatic or ad hoc, and to include the cost of COLAs in projections of pension benefit payments. GASB considers an ad hoc COLA to be “substantively automatic” when a historical pattern exists of granting ad hoc COLAs or when there is consistency in the amount of changes to a benefit relative to an inflation index. As part of efforts to contain costs and to ensure the sustainability of public pension plans, and in response to the current period of historically low inflation, many states have made changes to COLA provisions by adjusting one or more of the elements mentioned above. Since 2009, fifteen states have changed COLAs affecting current retirees, eight states have addressed current employees’ benefits, and seven states have changed the COLA structure only for future employees. The legality of these modifications in several states has been, or is, being challenged in court. The pace of reforms to COLA provisions has slowed considerably in recent years. Since 2015 just four states -- Arizona, Missouri, Nevada, and South Dakota -- enacted COLA reductions affecting one or more major employee groups. Legal rulings issued over the same period upheld COLA reductions passed in New Jersey, and fully or partially rejected COLA reductions passed in Illinois, Montana, and Oregon. A 2015 legal settlement pronounced material changes to COLA provisions for public employees in Rhode Island. The effects of a COLA can be consequential

both in protecting purchasing power and in adding costs to a plan. As states consider measures to ensure the sustainability of their pension plans for both those currently retired or employed, and for future generations of workers, policymakers are reexamining all aspects of benefit design and financing, including the way COLAs are determined and funded. Just as high periods of inflation in the past placed pressure on states to add or adjust COLAs upward, the recent low rates of inflation, combined with rising pension plan costs, have spurred action to reduce COLA levels. Some states have included provisions that would enable COLAs to increase should inflation grow or funding status or fiscal conditions improve. 2011 legislation terminated the automatic 3% compounded COLA for all service credits earned after 7/1/11 for the Florida Retirement System. (October 2016).

**3. HOW AMERICA SAVES 2016:** In a detailed 110-page report Vanguard has produced a detailed analysis entitled "*How America Saves 2016: A report on Vanguard 2015 defined contribution plan data.*" Over the past decade, plan sponsors have increasingly turned to plan design to influence employee retirement savings behavior. As a result, plan participation rates have improved and participant portfolio construction has also improved. However, as we look to the future, the main concerns affecting retirement savings plans still remain largely the same -- improving plan participation and contribution rates even further and continuing to enhance portfolio diversification -- enabling more individuals to retire with sufficient assets. Underlying the improvements in portfolio construction is the rising prominence of professionally managed

allocations. Participants with professionally managed allocations are those who have their entire account balance invested in a single target-date or balanced fund or in a managed account advisory service. At year-end 2015, about half of all Vanguard participants were solely invested in an automatic investment program --compared with just 29% at the end of 2010. Forty-two percent of all participants were invested in a single target-date fund; another 2% held one other balanced fund; and 4% used a managed account program. These diversified, professionally managed investment portfolios dramatically improve portfolio diversification compared with participants making choices on their own. Among new plan entrants (participants entering the plan for the first time in 2015), 8-in-10 were solely invested in a professionally managed allocation. Because of the growing use of target-date options, Vanguard anticipates that sometime during 2016, half of participants will be entirely invested in a professionally managed allocation -- and by 2020 that percentage will reach 68%. Use of target-date strategies in DC plans continues to grow. Nine in 10 plan sponsors offered target-date funds at year-end 2015, up 14% compared with year-end 2010. Nearly all Vanguard participants (98%) are in plans offering target-date funds. Sixty-nine percent of all participants use target-date funds. Sixty-two percent of participants owning target-date funds have their entire account invested in a single target-date fund. Four in 10 Vanguard participants are wholly invested in a single target-date fund, either by voluntary choice or by default. An important factor driving use of target-date funds is their role as an automatic or default investment strategy. The qualified default investment alternative (QDIA) regulations promulgated under the

Pension Protection Act of 2006 (PPA) continue to influence adoption of target-date funds. That said, voluntary choice is still important, with half of single target-date investors choosing the funds on their own, not through default. High-level metrics of participant savings behavior remained steady in 2015. The plan participation rate was 78% in 2015. The average deferral rate was 6.8% and the median was essentially unchanged at 5.9%. However, average deferral rates have declined slightly from their peak of 7.3% in 2007. The decline in average contribution rates is attributable to increased adoption of automatic enrollment. While automatic enrollment increases participation rates, it also leads to lower contribution rates when default deferral rates are set at low levels, such as 3% or lower. These figures reflect the level of employee-elective deferrals. Most Vanguard plans also make employer contributions. Taking into account both employee and employer contributions, the average total participant contribution rate in 2015 was 9.5% and the median was 8.8%. The adoption of automatic enrollment has grown by 50% since year-end 2010. At year-end 2015, 41% of Vanguard plans had adopted automatic enrollment, up five percentage points from 2014. In 2015, however, because larger plans were more likely to offer automatic enrollment, 63% of new plan entrants in 2015 were enrolled via automatic enrollment. Slightly more than 60% of all contributing participants in 2015 were in plans with automatic enrollment. The automatic enrollment feature, while initially applied only to new hires, has now been applied to eligible nonparticipants in half of Vanguard plans with the feature. Seven in 10 automatic enrollment plans have implemented automatic annual deferral rate increases. Almost all plans

with automatic enrollment -- 99% -- default participants into a balanced investment strategy, with 97% choosing a target-date fund as the default. At year-end 2015, the Roth feature was adopted by 60% of Vanguard plans and 15% of participants within these plans had elected the option. The authors anticipate steady growth in Roth adoption rates, given the feature's tax diversification benefits. In 2015, the average account balance for Vanguard participants was \$96,288; the median balance was \$26,405. In 2015, Vanguard participants' average account balances declined by 6% and median account balances fell by 11%. Two factors are driving the decline in participant account balances. The first is changing business mix -- new plans converting to Vanguard in 2015 had lower account balances. The second is the rising adoption of automatic enrollment, which results in more individuals saving but also in a growing number of smaller balances. By the end of 2015, more than one-third of participants had joined their plan under automatic enrollment. During the five-year 2010-2015 period, median balances declined by 2% and average balances rose by 22%. With essentially flat markets in 2015, the average one-year participant total return was -0.4%. Five-year participant total returns averaged 7.3% per year. Among continuous participants -- those with a balance at year-end 2010 and 2015 -- the median account balance rose by 105% over five years, reflecting both the effect of ongoing contributions and strong market returns during this period. More than 90% of continuous participants saw their account balance rise during the five-year period ended December 31, 2015. Given the growing focus on plan fees, there is increased interest among plan sponsors in offering a wider range of low-cost passive or index funds. A "passive

core” is a comprehensive set of low-cost index options that span the global capital markets. In 2015, half (54%) of Vanguard plans offered a set of options providing an index core. Over the past decade, the number of plans offering an index core has grown by nearly 90%. Because large plans have adopted this approach more quickly, about two-thirds of all Vanguard participants were offered an index core as part of the overall plan investment menu. Factoring in passive target-date funds, 69% of participants hold equity index investments. The percentage of plan assets invested in equities declined to 71%, essentially unchanged from 72% in 2014. Equity allocations continue to vary dramatically among participants. One in 8 participants has taken an extreme position, holding either 100% in equities (7% of participants) or no equities (5% of participants), although these extreme allocations have fallen in recent years as a result of the rise of target-date funds and other professionally managed allocations. Participant contributions to equities were unchanged in 2015 at 74%. In 2015, 46% of all new contributions to these plans were directed to target-date funds. During 2015, only 9% of DC plan participants traded within their accounts, while 91% did not initiate any exchanges. On a net basis, there was a shift of 0.8% of assets to fixed income in 2015, with most traders making small changes to their portfolios. Less than 1% of all participants actually abandoned equities during the year -- that is, shifted from a portfolio with some equity exposure to a portfolio with no equity exposure. Over the past decade, the authors have observed a decline in participant trading. The decline in participant trading is partially attributable to participants’ increased adoption of target-date funds. Only 2% of participants holding

a single target-date fund traded in 2015. A shift away from company stock holdings first observed in 2006 continued into 2015. Among plans offering company stock, the number of participants holding a concentrated position of more than 20% of their account balance fell from 31% in 2010 to 28% in 2015. In addition, the number of plans actively offering company stock to participants declined to 10% in 2015 from 11% in 2010. As a result, only 7% of all Vanguard participants held concentrated company stock positions in 2015, compared with 10% at the end of 2010. There was a slight decrease in new loans issued in 2015. In 2015, 16% of participants had a loan outstanding compared with 17% of participants in 2014. The average loan balance was \$9,900. Only about 2% of aggregate plan assets were borrowed by participants. During 2015, 4% of participants took an in-service withdrawal, withdrawing about 30% of their account balances. All in-service withdrawals during 2015 amounted to 1% of aggregate plan assets. Participants separating from service largely preserved their assets for retirement. During 2015, about 30% of all participants could have taken their account as a distribution because they had separated from service in the current year or prior years. The majority of these participants (85%) continued to preserve their plan assets for retirement by either remaining in their employer's plan or rolling over their savings to an IRA or new employer plan. In terms of assets, 97% of all plan assets available for distribution were preserved and only 3% were taken in cash. To read the entire analysis:

[https://pressroom.vanguard.com/nonindexed/HAS2016\\_Final.pdf](https://pressroom.vanguard.com/nonindexed/HAS2016_Final.pdf).

#### **4. NEARLY HALF OF YOUNG ADULTS LACK PENSION**

**RETIREMENT SAVINGS:** Young Americans with even just \$1 saved for retirement are ahead of the pack. Forty-eight percent of all Americans ages 18-to-30 have zero in retirement savings and no access to a traditional pension, according to a GenForward poll by the Black Youth Project at the University of Chicago with the Associated Press-NORC Center for Public Affairs Research. The youngest in that group are more likely to still be in school, but the trend also holds for those in their late 20s. More than 4-in-10 of those ages 25 to 30 have nothing for retirement. These same Americans are part of a generation whose future retirements, if they happen at all, will be more dependent on their personal savings. That is because traditional pensions are becoming more and more rare. Only 7% of those surveyed say they are in line to get the coveted benefit, which promises to pay a set amount monthly after retirement. Plus, young Americans are likely to get less in Social Security benefits than their parents or grandparents. The age to receive full Social Security benefits is climbing, up to 67 from 66. And most young Americans do not have much faith in the Social Security system to begin with. Only 5% say they are very confident in it, and 28% say they are somewhat confident. Despite all that, a majority of young Americans still say they are confident that they will have enough to retire when they want to. African-Americans, Asian-Americans and white Americans have similar levels of confidence, between 53% and 56%. Latinos are an exception. Only 43% say they are very or somewhat confident. More employers are looking to give their workers, young and old, a nudge to start saving for retirement by automatically enrolling them in 401(k)

plans. At plans administered by Vanguard, 41% of employers did so last year, up from 27% five years earlier. But to get that benefit, a worker needs a job that offers a 401(k) in the first place, and some younger Americans say it is difficult finding such a benefit. There is no magic answer for how much a person needs to have saved for retirement. T Fidelity suggests saving 15% of your income each year. Financial advisers suggest saving enough so that your nest egg at retirement is 25 times the annual expenses you will need to cover.

**5. AN INCREASE IN SOCIAL SECURITY BENEFITS IN 2017:** The annual cost-of-living adjustment usually means an increase in the benefit amount people receive each month. By law, the monthly Social Security and Supplemental Security Income federal benefit rate increases when there is a rise in the cost of living. The government measures changes in the cost of living through the Department of Labor's Consumer Price Index. According to the Social Security Matters blog the CPI-W rose this year. When inflation increases, your cost of living also goes up. Prices for goods and services, on average, are a little more expensive. Since the CPI-W did rise, the law increases benefits to help offset inflation. As a result, monthly Social Security and SSI benefits for over 65 million Americans will increase 0.3% in 2017. Other changes that would normally take effect based on changes in the national average wage index will begin in January 2017. For example, the maximum amount of earnings subject to the Social Security payroll tax will increase to \$127,200. Information about Medicare changes for 2017, when announced, will be available at [www.Medicare.gov](http://www.Medicare.gov). For some

beneficiaries, their Social Security increase may be partially or completely offset by increases in Medicare premiums. You can find more information about the 2017 COLA at [www.socialsecurity.gov/cola](http://www.socialsecurity.gov/cola). For changes in the national average wage index, go to [www.socialsecurity.gov/OACT/COLA/AWI.html](http://www.socialsecurity.gov/OACT/COLA/AWI.html).

## **6. POTENTIAL SOLVENCY LIABILITY DISCLOSURE MAY HAVE SIGNIFICANT IMPLICATIONS FOR PUBLIC EMPLOYEE RETIREMENT SYSTEMS:**

*GRS Perspectives* has issued a new white paper entitled “*Potential Solvency Liability Disclosure May Have Significant Implications For Public Employee Retirement Systems.*” In recent years, Public Employee Retirement Systems have adjusted to having two separate liability calculations: 1) the actuarial accrued liability for funding purposes; and 2) the total pension liability for the new Governmental Accounting Standards Board accounting disclosures. Now, there is a third potential liability calculation on the horizon: solvency liability. Solvency liability is a market-based measurement of the present value of accrued benefits discounted at risk-free interest rates. In the current low interest rate environment, a pension plan’s solvency liability would likely be significantly higher than its actuarial accrued liability or total pension liability. Why introduce this new measure? Will PERS be required to disclose solvency liability? How can solvency liability be useful to trustees and other stakeholders? And, most importantly, what do trustees need to know about solvency liability in order to effectively communicate what it means and what it does not mean? To read *GRS Perspectives* which addresses these questions

and other relevant issues, visit: <http://www.grsconsulting.com/wp-content/uploads/2016/10/GRS-Perspectives-Solvency-Liability-Final.pdf>.

**7. SEC ANNOUNCES ENFORCEMENT RESULTS FOR FY 2016:** The Securities and Exchange Commission announced that, in fiscal year 2016, it filed 868 enforcement actions exposing financial reporting-related misconduct by companies and their executives and misconduct by registrants and gatekeepers, as the agency continued to enhance its use of data to detect illegal conduct and expedite investigations. The new single year high for SEC enforcement actions for the fiscal year that ended September 30 included the most ever cases involving investment advisers or investment companies (160) and the most ever independent or standalone cases involving investment advisers or investment companies (98). The agency also reached new highs for Foreign Corrupt Practices Act-related enforcement actions (21) and money distributed to whistleblowers (\$57 million) in a single year. The agency also brought a record 548 standalone or independent enforcement actions and obtained judgments and orders totaling more than \$4 billion in disgorgement and penalties. “By every measure the enforcement program continues to be a resounding success holding executives, companies and market participants accountable for their illegal actions,” said SEC Chair Mary Jo White. “Over the last three years, the SEC has changed the way they do business on the enforcement front by using new data analytics to uncover fraud, enhancing its ability to litigate tough cases, and expanding the playbook bringing novel and significant actions to better protect investors and our markets.” The SEC’s most significant

enforcement actions in fiscal year 2016 include:

- Insider trading and beneficial ownership reporting-related charges against Leon G. Cooperman and his firm Omega Advisors.
- Insider trading charges against William “Billy” Walters and his source Thomas C. Davis, a former Dean Foods Company board member.
- A \$415 million enforcement action against Merrill Lynch for violating customer protection rules by misusing customer cash and putting customer securities at risk. The firm also admitted wrongdoing.
- A \$267 million enforcement action against J.P. Morgan wealth management subsidiaries, for failing to disclose conflicts of interest to clients. The firms also admitted wrongdoing.
- FCPA cases against the Och-Ziff hedge fund and its CEO and CFO and against VimpelCom Ltd. in which the companies paid hundreds of millions of dollars to settle the charges.

“This has been a strong year for the Enforcement Division, with groundbreaking insider trading and FCPA cases and other important actions across the full spectrum of the securities laws,” added Andrew J. Ceresney, Director of the SEC’s Enforcement Division. “Through their hard work and steadfast dedication to its mission, the Division’s committed staff have helped protect investors and made our markets fairer and more reliable.” The agency also brought impactful first-of-their-kind actions in fiscal year 2016, including charges against: a firm solely for failing to file Suspicious Activity Reports when appropriate; an audit

firm for auditor independence failures predicated on close personal relationships with audit clients; municipal advisors for violating the fiduciary duty for municipal advisors created by the 2010 Dodd-Frank Act and the municipal advisor antifraud provisions of the Dodd-Frank Act; a private equity adviser for acting as an unregistered broker; and an issuer of retail structured notes for misstatements and omissions. In addition, fiscal year 2016 included a first-of-its-kind trial victory: the first federal jury trial by the SEC against a municipality and one of its officers for violations of the federal securities laws.

**8. HOW PRIVATIZATION INCREASES INEQUALITY:** In a new report "*How Privatization Increases Inequality*" by *In The Public Interest* says inequality in the United States, which began its most recent rise in the late 1970s, continues to surge in the post–Great Recession era. During similar eras -- such as the New Deal -- many of the public goods and services we value today were created to deliver widespread prosperity. But the way in which cities, school districts, states, and the federal government deliver things like education, social services, and water profoundly affects the quality and availability of these vital goods and services. In the last few decades, efforts to privatize public goods and services have helped fuel an increasingly unequal society. This report examines the ways in which the insertion of private interests into the provision of public goods and services hurts poor individuals and families, and people of color. Quality public goods and services are fundamental to a prosperous society. Everyone benefits when government creates and supports public schools and universities,

transportation systems, parks and libraries, and water systems; and ensures that public systems help people at their most vulnerable, such as a fair criminal justice system and compassionate social safety net. But privatization, a key pillar of political attacks on government in the last few decades, has weakened many public goods and services and excluded more and more Americans from full participation in the political and economic systems that shape their lives. As former Secretary of Labor Robert Reich explains, “‘Privatize’ means ‘Pay for it yourself.’” The practical consequence of [privatization] in an economy whose wealth and income are now more concentrated than at any time in the past 90 years is to make high-quality public goods available to fewer and fewer.” As this report shows, privatization has threatened the very goals and missions of many public goods and services, especially those that the poor interact with the most. Instead of a shared responsibility to fund public services, in many cases, the burden has shifted to the backs of the most vulnerable, while corporations managing these services skim off profits. Private companies have left social safety net programs in tatters. Many workers employed by government contractors have plunged further into poverty because of declining wages and benefits. And as private interests continue to siphon money away from public services, the dismantling of public goods not only perpetuates pervasive economic inequality, but also contributes to increasing racial segregation. In the Public Interest’s analysis of recent government contracting identifies five ways in which government privatization disproportionately hurts poor individuals and families, each of which is explored in greater detail in the five main sections of the report:

- **Creation of new user fees:** the creation of new user fees to fund public services disproportionately impacts the poor. As government budgets have declined, some jurisdictions have tried outsourcing services to private companies and allowing in the public interest.org. How privatization increases inequality -- those companies to charge fees to the end-user to subsidize or completely fund the service. Many of the services that use this contracting and payment structure are those that poor individuals and families must use or are subject to through their interactions with the government. Furthermore, this regressive user fee approach can fundamentally distort a service's goals and mission, as evidenced by the changing nature of many services within the criminal justice system, such as probation.
- **Increase in existing user fees:** some public services have traditionally been subsidized or funded through usage fees to the end user. However, residents of jurisdictions that have privatized critical public services such as water or transit have experienced steep increases in their rates -- such increases particularly harm low-income residents and those on fixed-incomes. Private control of these public services and assets can allow corporations increased influence in pricing and rate levels. Too often, rate hikes do not translate into improved service quality, but instead pad corporate bottom lines.
- **Privatization of the social safety net:** programs that provide and deliver critical support to the poor are often the subject of

privatization experiments, many times with tragic results. Because these programs assist those who have little to no political power, these programs are low hanging fruit for privatization. The complex social problems faced by families and children who utilize services like food assistance (SNAP) and Medicaid are difficult, if not impossible, to address using a privatization model, as the need to help recipients with difficult problems and a contractor's interest in extracting profits from the service are often incompatible.

- **Decreased wages and benefits:** privatization increases income inequality through the decline of contracted workers' wages and benefits. When governments directly provide a service, they often provide living wages and decent benefits to workers. When private companies take control, they often slash wages and benefits in an attempt to cut labor costs, replacing stable, middle class jobs with poverty-level jobs. Reduced worker wages and benefits not only hurt individual workers and their families, but also local economies and the stability of middle and working class communities.
- **Increased socioeconomic and racial segregation:** the introduction of private interests into public goods and services can radically impact access for certain groups. In some cases, as the public park example in Section 5 shows, privatization can create parallel systems in which one system propped up by private interests typically serves higher-income people, while another lesser quality system serves lower-income people. In other cases, the creation of a private system, such as charter schools in a school district, siphons funding away from the public system meant

to serve everyone. In some situations, poor individuals and families can lose access to the public good completely. All of these cases increase socioeconomic segregation, which often results in racial segregation. When they are privatized, public goods that were meant to serve everyone can morph into separate and unequal systems that further divide communities and perpetuate inequality. In these ways, privatization weakens democratic control over public goods and services and increases economic, political, and racial inequality. But it is crucial to note that privatization is one part of a downward spiral exacerbating the country's already historic inequality. Though state revenues are starting to inch closer to pre-recession levels, recovery for state and local governments has been slow, uneven, and incomplete. This has decreased funding for public goods and services that more and more Americans, due to increasing inequality, have been forced to rely upon. Too often, the answer to this funding dilemma is privatization, which proponents claim is more cost effective than government provision. But cost savings are often unrealized, and, as this report shows, for many Americans -- especially the most vulnerable -- the impacts of privatization are deeper than monetary costs alone. How privatization increases inequality concludes with recommendations for addressing some of the many problems with privatization identified in this report. We need policies that:

- **Adequately fund public goods and services:** governments must choose to make wise public funding decisions that maintain and improve our public services and assets. This includes funding

public services with high rates of social and economic return, including education and infrastructure; ensuring adequate funding for services that can have severe negative consequences for future budgets if neglected, such as programs that provide support for children in poverty; and enacting reforms that have proven to produce significant budgetary savings, such as sentencing reforms in local and state criminal justice systems.

- **Fully measure the impact of a potential privatization:** governments should conduct a robust social and economic impact analysis before privatizing to determine potential impacts on those who use the service or asset, workers, residents, and businesses.
- **Ensure government contracts do not undermine shared economic prosperity:** all governments should require contractors to show that cost savings derive from increased efficiencies and innovation, not a decrease in worker compensation. Additionally, governments should require contractors to pay living wages and provide decent benefits to workers.
- **Dramatically increase transparency in government contracting:** state and local governments should track how much money is spent on private contracts, how many workers are employed by those contracts, and worker wage rates. This information should be readily available to the public.

These recommendations will go a long way towards addressing inequality and restoring the concept of the common good and the very sense of “community” that sustains a healthy, equitable society. To read

the entire report visit: [https://www.inthepublicinterest.org/wp-content/uploads/InThePublicInterest\\_InequalityReport\\_Sept2016.pdf](https://www.inthepublicinterest.org/wp-content/uploads/InThePublicInterest_InequalityReport_Sept2016.pdf). (September, 2016).

## **9. GOVERNING FOR RESULTS -- A TRANSITION AND MANAGEMENT AGENDA TO LEAD POLICY CHANGE IN A NEW**

**ADMINISTRATION:** Transitions in Governance 2016 has issued a white paper entitled “*Governing for Results -- A Transition and Management Agenda to Lead Policy Change in a New Administration.*” No matter who wins the White House in 2016, promoting the effective and efficient management of the federal government should be a shared bipartisan goal. Each election cycle a diverse coalition of good-government groups have sponsored a variety of projects to help inform the incoming Administration on federal management issues. The goals of the project:

- Develop a bold set of ideas to comprise a Management Reform Agenda for the incoming President and Congress to consider that focuses on improving results, transparency and efficiency of the federal government -- and in doing so helps the new President achieve their agenda.
- Expand the Government Performance Coalition of think tanks, elected officials, and other stakeholders to support the bipartisan implementation of a federal management improvement agenda post 2016.

The white paper summarizes the recommendations surfaced throughout

an 18-month research effort involving a bipartisan collection of political and career officials in a variety of Administrations. Throughout the Transition and after Inauguration, the Transitions Initiative will continue to engage the new Administration officials on assisting with the effective and efficient implementation of their agenda. The Transitions in Governance Initiative is supported by a coalition of good-government groups. While these groups may differ on specific policy ideas and have their own individual proposals, the groups share a commitment that the incoming President and Congress adopt a clear agenda for improving the management of the federal government. Individual coalition members have conducted additional research projects related to the Transition and improving federal management. Information on those projects can be accessed on their websites. To view the entire informative paper: <https://gallery.mailchimp.com/b7de61719141ea27646be0c7d/files/Transitions2016Report.pdf>. (October 17, 2016).

#### **10. WHAT ADVISERS NEED TO KNOW ABOUT THE MEGA-RICH:**

More individuals are reaching billionaire status but the total wealth held by the nation's jet set is contracting. The billionaire population grew by 1% but their total assets fell by 6% in 2015, according to *Billionaire Insight*, a study conducted by UBS and PWC. Many clients are seeing their wealth shrink, especially through intergenerational transfers. In fact, the number of self-made billionaires is taking over inherited wealth, the study says.

- **1% growth for the billionaires club.** Assets of the nations' richest

might have declined, but the number of billionaire individuals are growing. The billionaire population grew by 1% to 538 in 2015.

- **The combination of age and wealth.** The nations' richest hold a total of \$2.47 trillion in assets. Billionaires over the age of 70 have \$1.17 trillion while their younger peers own \$1.3 trillion.
- **What lies ahead?** A total of \$2.1 trillion is in the hands of fewer than 500 people. This group is expected to transfer that wealth to their heirs in the next two decades.
- **Young money fared better than old.** The wealth of self-made billionaires fell from \$4.7 billion to \$4.5 billion per individual. Those who inherited their billionaire status watched their fortunes contract at a faster rate of 16%, from \$5.1 billion to \$4.3 billion.
- **How the rich become...less rich.** Business volatility accounts for over 60% of all wealth contraction among billionaires.
- **How effective is the great wealth transfer?** Since 1995, 70% of billionaire fortunes did not survive past the first generation. Another 20% did not remain intact past the second generation.
- **Where is the money?** Led by China, Asia is creating one billionaire every three days. In 2015, 113 Asian entrepreneurs attained billionaire status.

## **11. IRS WEBINAR: ACA OUTREACH FOR STATE AND LOCAL**

**GOVERNMENT EMPLOYER COMMUNITY:** There is a live webinar taking place on Thursday, October 20th at 2 p.m. ET presented by the ACA Office and TE/GE Counsel to address governmental entities' concerns and needs as they relate to ACA information reporting

requirements. [Register for this event](#) to learn about:

- Determining Applicable Large Employer (ALE) status
- Identifying full-time employees
- Defining hours of service
- What is Minimum Essential Coverage?
- E-Filing of information returns
- 2016 filing season corrections and replacements
- Penalties and relief
- TIN solicitation
- Changes to forms & instructions for Tax Year 2016
- Questions and answers

## **12. 46TH ANNUAL POLICE OFFICERS' AND FIREFIGHTERS'**

**PENSION TRUSTEES' SCHOOL:** The 46th Annual Police Officers' & Firefighters' Pension Trustees' School will take place November 2 through 4, 2016. You may access information and updates about the Conference, including area maps, a copy of the program when completed and links to register at the Radisson Resort, Celebration, (Orlando) Florida Please continue to check the FRS website for updates regarding the program at [www.myflorida.com/frs/mpf](http://www.myflorida.com/frs/mpf). 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 unique, insightful and informative program.

**13. FUN WITH WORDS:** A will is a dead giveaway.

**14. PARAPROSDOKIAN:** I was going to wear my camouflage shirt today, but I could not find it.

**15. TODAY IN HISTORY:** In 1803, Senate ratified the Louisiana Purchase.

**16. 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.

**17. 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>.

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