



CYPEN & CYPEN
NEWSLETTER
for
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Never Forget September 11, 2001
and
Always Remember May 2, 2011

1. 2016 NCPERS PUBLIC RETIREMENT SYSTEMS STUDY:
National Conference on Public Employee Retirement Systems undertook a comprehensive study exploring retirement practices of the public sector. The study includes responses from 159 state, local and provincial government pension funds with more than 10 million

active and retired memberships and assets exceeding \$1.5 trillion. The majority, 77%, were local pension funds, while 23% were state pension funds. NCPERS is the largest trade association for public sector pension funds, representing more than 500 funds throughout the United States and Canada. It is a unique nonprofit network of public trustees, administrators, public officials and investment professionals who collectively manage nearly \$3.7 trillion in pension assets. Founded in 1941, NCPERS has been the principal trade association working to promote and protect pensions by focusing on advocacy, research and education for the benefit of public sector pension stakeholders. Here are some key findings:

- The trend of public funds becoming more cost effective continues. Responding funds report the total cost of administering their funds and paying investment managers is 56 basis points. This number is a decrease of four basis point from 2015. According to the 2016 Investment Company Fact Book, the average expenses of most equity mutual funds average 68 basis points, and hybrid mutual funds average 77 basis points. Thus, funds with lower expenses provide a higher level of benefit to members (and produce a higher economic impact for the communities those members live in) than most mutual funds.
- Funds continue to tighten benefits and assumptions. Almost 40% of responding funds have lowered their actuarial assumed rate of return, and nearly an additional 30% are considering

lowering in the future. More than 30% of respondents have increased employee contributions and raised benefit age or service requirements.

- Funds are currently experiencing healthy 3-year, 5-year and 20-year returns (close to or exceeding 8%). Aggregated 10-year returns are reported at 6.2%. Gross 1-year returns averaged 1.7%, and varied between 1.2% (June) and 2.4% (December) depending on two common fiscal year end dates. Signs continue to point toward long-term improvement in responding public retirement systems' funded status.
- For the third consecutive year, responding funds experienced an increase in average funded level. The aggregated average funded level is 76.2, up from 74.1 in 2015 and 71.5 in 2014. While 1-year investment returns were not strong in 2015, almost 70% of responding funds have investment smoothing periods containing strong investment returns from the 2012, 2013 and 2014 fiscal years. In addition, funds continue to lower amortization periods, which lowers the amount of time to fully fund the plan.
- Income used to fund pension programs usually comes from three sources: member contributions, employer contributions and investment returns. Investment returns are the most significant source (73.8%). Member contributions make up 7.5% of fund income. Employer contributions equal about 18.7%.

2. U.S. SUPREME COURT WILL DECIDE IMPORTANT ISSUE

AFFECTING TIMELINESS OF SECURITIES CLAIMS: On January 13, 2017, the Supreme Court granted a petition for a writ of certiorari - that is, it agreed to hear an appeal -- in a case that presents a vitally important question for institutional investors. In this case, *California Public Employees' Retirement System v. ANZ Securities, Inc.*, No. 16-373, the Court will decide whether the filing of a putative class action tolls the three-year time limitation in Section 13 of the Securities Act of 1933 with respect to putative class members' claims under Sections 11 and 12 of the Securities Act. The Court's decision may also apply to the similar five-year time limitation applicable to claims under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5. We thank Bernstein Litowitz for this report.

3. DB PLANS STILL THE BEST WAY TO GO: The New Year is a time for positive thoughts, according to H.C. Foster & Company, actuaries. And no topic deserves positive thoughts more than defined benefit plans; that serve our nation as the least-cost means to fund retirement benefits. Following are some of Foster's thoughts:

- DB plans allocate annual funding costs first to those nearest a plan's retirement age and in benefit payment status proportionally to age, compensation levels and length of service with the employer. These current and former employees have contributed the most to building and sustaining a business organization.

- DB plans replace active working-life wages at retirement for the longer living of the participant and his or her spouse. Forfeitures from short-service employees reduce funding costs for remaining employees. Every dollar of defined benefit plan funding costs and expenses to a properly designed plan flows directly to provide retirement benefits for employees.
- Proper DB plan design directs retirement funding to the most productive segments of an employee group within nondiscrimination requirements. These employees will remain employed to reduce employee turnover and retraining costs.
- Retaining plan assets in unallocated pooled investment funds through a discount brokerage firm exposes and minimizes all charges to avoid unnecessary sales and administrative charges. The middleman is removed.

An employee needs to know that at his retirement age a portion of his active working-life wages will be replaced by monthly life annuity income. The employee knows with reasonable precision his expected DB retirement benefits upon which he can base future life decisions. The worker toils on behalf of his employer with good feelings about his future economic security.

DB Plans Same as Social Security Retirement Benefits

- Social Security retirement benefits are defined benefit pension benefits. Efforts to convert the Social Security retirement system to an account balance arrangement have failed.

- The public realizes an account balance plan passes the risk of adequate retirement income from a massive pension fund with risks spread over 100 or more years to individual retirees with the possibility of severe market value declines when retirement income is most needed.
- We know of no DB plan critics who refuse their Social Security retirement benefits.

DB Plan Participants Understand Their Benefit Plans

- The specious argument that DB plans are so complicated employees cannot understand their benefits are disproved any time you hear union and public employee plan participants discuss their retirement benefits.
- Workers seek and retain public and union employment for the benefits.
- Employees are fully aware of their DB plan coverages, and always know when their DB plan coverage has been terminated or replaced by an account balance plan.
- Employers and employees having the financial literacy to understand their benefit plans are not easily led to retail cost IRA-type arrangements requiring 100% vesting and not generating sufficient retirement benefits.
- Employees' feelings about the employer are rarely positive when their DB plan benefits are curtailed, and understand the employer is transferring risk to them traditionally borne by employers.

- Employees want guaranteed retirement income as part of their compensation packages.

DB Plans Reduce Employers' Compensation Costs

- An employee's total compensation consists of his Form W-2 wages plus his employer's costs for retirement and other benefit costs, including Social Security matching, unemployment benefits, workers' compensation, and fringe benefits. With proper communications, employees understand benefit costs are a significant part of their total compensation packages, and will accept reduced Form W-2 wages in exchange for tax deferred benefits funding.
- DB plans reduce employers' total compensation costs because compensation dollars contributed to a DB plans in lieu of Form W-2 wages ultimately provide larger compensation packages for older, longer-service employees under a benefit formula chosen by the employer to meet its objectives and cost constraints.
- Annual wage and benefit plan costs can be systematically aligned with an employer's profit objectives and the commercial value of each employee.

Why the Number of DB Plans Decline

The regulatory maze of overly complicated IRS, PBGC, and DOL regulations overshadows the real issues of cost efficiency and employees' retirement income security.

Societal changes in the United States leave little allegiance between employers and employees with employers no longer seen as trusted sources of future retirement income security. Employees do not demand real pension benefits, and often squander their lump sum distributions and account balances frivolously.

Our society's short-term mentality undermines the private pension system.

Historically low fixed income interest rates under a federally managed economy since 2008 have created abnormally high lump sum distributions present values for plans that pay them. This situation will correct itself with increasing interest rates dramatically to decrease future lump sum distributions present values.

4. STATE OFFICIALS CAUSED MICHIGAN'S PENSION CRISIS:

According to michigancapitolconfidential.com, the Ann Arbor public school district was required to contribute \$30.0 million to the state's underfunded school employee pension system in 2016. That represented a \$16.8 million increase in just five years: In 2011, the Washtenaw County district paid \$13.2 million. Across the state, skyrocketing costs resulting from the failure of those in charge properly to fund Michigan's school pension system are causing problems for the budgets of virtually every conventional public school district. The crisis has been decades in the making. One factor has

been the agency that manages state and school pension systems; it has consistently made decisions based on optimistic assumptions. This failure combined with others has put taxpayers on the hook for \$26.7 billion worth of unfunded promises in the school pension system. In the coming weeks, Michigan Capitol Confidential will examine how officials in the state's Office of Retirement Services and elsewhere have created this unsupported debt. For at least 41 of the past 42 years, the school pension fund has not held enough assets to meet the promises made to those who have earned pension benefits. The underfunding has compounded over time to create the current unfunded liability. The ORS has consistently low-balled its official estimates of how much needs to be contributed to the pension fund each year to catch up on past underfunding. And in 14 of the past 20 years, the Legislature has compounded the damage by failing to appropriate enough money to cover even those understated estimates. The pension system's managers have continually shunned best practices, by assuming that they have an unreasonably long time to catch up on the past underfunding. For example, records show that in 1975, the state was using a 50-year amortization window, which is 20 years longer than current industry recommendations. Just like going from a 15-year mortgage to 30-year one greatly increases how much a homeowner pays over the life of a loan, this bit of practice could cost taxpayers billions of dollars more in the coming decades. Yet the retirement office defends its management record. For example, it points to the fully funded status of a slightly less generous defined benefit pension option the state began offering to new school

employees in 2010. This plan also includes employer contributions to a 401(k)-like account owned by each employee. (Politicians call this a hybrid system.) Importantly, 401(k)-like defined contribution retirement plans by definition create no long-term employer liabilities, funded or unfunded. The employer's obligation is met completely each time it deposits a periodic contribution to an employee's tax-deferred account. The employer who has promised these contributions gets no more credit for making them than for making payroll on time. For that reason, there may be less than meets the eye in the following defense offered by the retirement office's spokesperson, Kurt Weiss:

"This administration is proud of the way we have managed all of the state's retirement systems and particularly proud of the needed reforms that have been made that have reduced the state's long-term liabilities by more than \$20 billion. It is important to understand that the defined benefit system is closed to new enrollees and equally important to understand that the hybrid system is funded at 100%."

The closed system Weiss refers to covers employees hired before 2010, who get a defined benefit pension but no employer 401(k) contributions. Employees hired since 2010 get a defined benefit pension with a slightly less generous payout formula as well as modest employer 401(k) contributions. Both the old approach and the new one generate long-term taxpayer liabilities. Whether either is funded or underfunded depends on how it is managed. Contributions to the school pension fund made on behalf of employees hired since

2010 have gone into investment markets that have not experienced a serious drawdown in that time.

5. AMERICANS CLAMBER TO RETIRE OUTSIDE THE UNITED

STATES: *Associated Press* says that as retirees look for ways to expand limited incomes, one unconventional but growing trend is a move to a country where one's retirement dollars can be stretched further. There are many reasons that retirees leave the country, some being lower costs of living, ability to buy into more cost-effective state-run health care systems like in Japan a more temperate climate. The Pension Research Council weighs the benefits of living abroad as a retiree, such as potential ability to hire long-term health givers, against losing some benefits back home, namely Medicare.

6. FLSA FACTS TO KEEP YOU OUT OF THE COURTROOM: Curt Barone has put together a practical guide to the Fair Labor Standards Act for fire departments. In addition, Barone, a veteran fire fighter and practicing attorney in two states, will be participating in a three-day program in a comprehensive overview of wage and hour issues in the fire emergency services. He will address the most important topics governed by the Fair Labor Standards Act, including overtime requirements, maximum hours, determining regular rate, comp time, substitution and retribution. One such program, hosted by Miami-Dade fire rescue, will be held May 9-11, 2017. Look for registration information.

7. HOW THE IRS TAXPAYER BILL OF RIGHTS WORKS: The Internal Revenue Service says that taxpayers have fundamental rights under the law. The “Taxpayer Bill of Rights” presents these rights in 10 categories. This helps taxpayers when they interact with the IRS. Publication 1, Your Rights as a Taxpayer, highlights a list of taxpayer rights and the agency’s obligations to protect them. Here is a wrap-up of the Taxpayer Bill of Rights:

- **The Right to Be Informed.** Taxpayers have the right to know what is required to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices and correspondence. They have the right to know about IRS decisions affecting their accounts and clear explanations of the outcomes.
- **The Right to Quality Service.** Taxpayers have the right to receive prompt, courteous and professional assistance in their dealings with the IRS and the freedom to speak to a supervisor about inadequate service. Communications from the IRS should be clear and easy to understand.
- **The Right to Pay No More than the Correct Amount of Tax.** Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties. They should also expect the IRS to apply all tax payments properly.
- **The Right to Challenge the IRS’s Position and Be Heard.** Taxpayers have the right to object to formal IRS actions or

proposed actions and provide justification with additional documentation. They should expect that the IRS will consider their timely objections and documentation promptly and fairly. If the IRS does not agree with their position, they should expect a response.

- The Right to Appeal an IRS Decision in an Independent Forum. Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including certain penalties. Taxpayers have the right to receive a written response regarding a decision from the Office of Appeals. Taxpayers generally have the right to take their cases to court.
- The Right to Finality. Taxpayers have the right to know the maximum amount of time they have to challenge an IRS position and the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS concludes an audit.
- The Right to Privacy. Taxpayers have the right to expect that any IRS inquiry, examination or enforcement action will comply with the law and be no more intrusive than necessary. They should expect such proceedings to respect all due process rights, including search and seizure protections. The IRS will provide, where applicable, a collection due process hearing.
- The Right to Confidentiality. Taxpayers have the right to expect that their tax information will remain confidential. The IRS will

not disclose information unless authorized by the taxpayer or by law. Taxpayers should expect the IRS to take appropriate action against employees, return preparers and others who wrongfully use or disclose their return information.

- **The Right to Retain Representation.** Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.
- **The Right to a Fair and Just Tax System.** Taxpayers have the right to expect fairness from the tax system. This includes considering all facts and circumstances that might affect their underlying liabilities, ability to pay or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

The IRS will include Publication 1 when sending a notice to taxpayers on a range of issues, such as an audit or collection matter. IRS offices display the rights for taxpayers and employees to see. Publication 1 is available in English, Chinese, Korean, Russian, Spanish and Vietnamese. All taxpayers should keep a copy of their tax return. Beginning in 2017, taxpayers using a software product for the first time may need their Adjusted Gross Income (AGI) amount from their

prior-year tax return to verify their identity. Taxpayers can learn more about how to verify their identity and electronically sign tax returns at Validating Your Electronically Filed Tax Return. IRS Special Edition Tax Tip 2017-01, January 17, 2017.

8. OUR NEW MAILING ADDRESS: Please note that Cypen & Cypen has a new mailing address: Cypen & Cypen, 975 Arthur Godfrey Road, Suite 500, Miami Beach, Florida 33140. All other contact information remains the same.

9. FPPTA TRUSTEES SCHOOL: The Florida Public Pension Trustees Association's Annual Trustees School Conference will take place on January 29, 2017 through February 1, 2017 at the Rosen Centre Hotel, Orlando. A link on FPPTA's web site, www.fppta.org, will take you to the Rosen Centre Hotel site to make your room reservations. You may access information and updates about the Conference at FPPTA's website. 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 conference.

10. CRAZY STATE LAWS: *Good Housekeeping* reminds us that there are crazy laws in every state. In Alabama, it is illegal to drive blindfolded. Sounds like word did not make it to everyone in the Yellowhammer State about the common phrase "Keep your eyes on the road." Our eyes are wide open after hearing this one!

11. ZEN PROVEN TEACHINGS TO LIVE BY: If you think nobody cares whether you are alive or dead, try missing a couple of bill payments.

12. PONDERISMS: Why does a round pizza come in a square box?

13. TODAY IN HISTORY: In 1989, Phoenix Suns cancel game at Miami Heat, due to racial unrest in Miami.

14. 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.

15. 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>.

16. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED

RETIREMENT BENEFIT.