



CYPEN & CYPEN

NEWSLETTER

for

May 18, 2017

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

1. WHY PENSIONS MATTER: The National Public Pension Coalition (NPPC), (<http://ippfa.org/pensions-matter-source-nppc/>), reports that in the broadest sense, pensions have existed since ancient Rome. Soldiers in the Roman army could earn pensions through their military service. The value of these pensions to Roman

soldiers helped to maintain the power of emperors such as Augustus. Pensions for military service have continued to exist in one form or another in the two thousand years since. Public pensions for teachers, firefighters, police officers, and other civilian public servants in the United States are a more recent development. In fact, public pensions as we know them are just over one hundred years old. Governments began offering pensions because they are the most effective and cost efficient way for working families to prepare for retirement. Unfortunately, many people today have forgotten the true value of pensions and why they are so important. The report explores the history of defined benefit public pensions in the United States, why they were implemented in the first place and why they continue to remain today. The following is a condensed version:

A. What is a pension?: A pension is any form of payment, other than wages, paid at regular intervals for past service, age, injury or other reasons. A defined contribution plan, such as a 401(k), is not a pension, but rather a retirement savings plan. In a defined contribution plan, the worker can contribute a certain amount while working in order to accumulate savings for retirement.

B. Early Public Pensions: The first public pension plan in the United States was established in New York City in 1857. That pension plan provided a lump sum payment to New York City police officers injured in the line of duty. In 1866, that same coverage was extended to New York City firefighters.

C. Social Security Act and the New Deal Era: The growth of public pension plans accelerated during the New Deal era. The stock market crash of 1929 and ensuing Great Depression cast millions of elderly Americans into poverty. Responding to this crisis, Congress passed the Social Security Act in 1935. Originally, the Social Security Act precluded employees of state and local governments from participating in the Social Security program.

D. Pensions in the Private Sector: Defined benefit pensions also became more common in the private sector during the postwar period. Particularly as manufacturing jobs increased during the postwar economic boom, those jobs often came with a middle class salary and benefits, including a defined benefit pension. During the 1950s and 1960s, private sector pension plans were largely unregulated. This sometimes led to unfortunate consequences when businesses closed down. The most notorious example was the closure of the Studebaker Company in 1963. Eventually, Congress passed the Employee Retirement Income Security Act, which President Ford signed into law on Labor Day in 1974. It is important to note that ERISA and its provisions do not generally apply to public pension plans.

E. Birth of the 401(k): One of the most consequential laws relating to retirement plans in the United States was the Revenue Act of 1978. This legislation contained a minor provision creating Section 401(k) of the tax code. This provision was passed to give well-paid

corporate executives a way to save some of their high earnings in tax-advantaged savings accounts. For the first few years of its existence, the 401(k) provision went unnoticed. However, following Ronald Reagan's election as president, the IRS changed the regulations regarding 401(k) plans and dramatically increased their popularity in the private sector.

F. Defined Benefit Plans Continue in the Private Sector: The overwhelming shift to defined contribution plans has not occurred in the public sector. Many public employees still participate in a traditional defined benefit pension plan. There are several reasons for this. For one, the laws that increased the regulatory burden on private sector pension plans do not apply to public sector plans. For another, state and local governments value a stable workforce. In professions like teaching, firefighting, and policing, employees gain skills and increase in effectiveness over time. Frequent employee turnover hurts these professions. Additionally, there are not private sector equivalents of many public sector jobs. It is much more difficult to find employees with the skills to start doing these jobs on day one, whereas a private company might find it easier to replace one engineer with another. Therefore, it is in the best interest of these employers to maintain an experienced, long-term workforce. Critics of public pensions often complain that these pension plans have long vesting periods and reward the longest serving employees. That protocol is intentional. In public education, for example, most research points to teachers dramatically increasing their effectiveness during

their first few years of teaching and then maintaining that effectiveness throughout their career. They do not lose their effectiveness the longer they continue in their profession. They are more likely to continue teaching at their peak effectiveness rather than decline. Structuring retirement plans to reward teachers that only teach for three or four years does not make sense because that would reward teachers who leave before reaching their peak effectiveness, often to be replaced by someone without any experience. Similarly, with firefighting and policing, there are a lot of sunk costs that go into training new recruits. It is not in the interest of these departments for their new employees to leave right after training, so their pension plans are structured to promote long-term commitment to the profession. One of the major issues surrounding public pensions is the question of why taxpayers should pay for them. It is important to be clear about exactly what that means. Public pension funds get money from three sources: employee contributions; employer contributions; and investment returns. In the public sector, the employer is a state or local government entity, such as the local police department or public school system, and, therefore, the money to fund that government entity comes from taxpayers. On average nationwide, public sector employers contribute about a quarter of public pension fund revenues. The majority of pension fund revenues comes from the employee's own contributions and the investment returns on the combined contributions. Taxpayers are only paying for a small part of the cost of public pension plans. State and local governments offer defined benefit pensions to their employees in

order to attract the best and brightest to public service. Public employees earn less on average than their counterparts in the private sector, so job benefits like pensions are a proven way to recruit top talent. Also, as discussed above, pensions play a key role in retaining employees in professions like teaching and firefighting. The important question that does not get asked in this discussion is: why do private companies not offer defined benefit pensions anymore? Defined benefit pensions are more efficient and cost-effective than defined contribution plans and provide a more secure retirement. Public pensions should not be considered the outlier in the retirement security landscape. Instead, workers should be asking why their company is not offering a pension plan.

G. Decline of Retirement Security in the Private Sector: In the private sector, the shift from defined benefit pensions to defined contribution 401(k) plans over the past three decades has harmed the retirement security of working families. Most working families accumulate far less in retirement savings with a defined contribution plan than they would with a defined benefit pension. By their nature, 401(k) plans favor high-income workers; that is, after all, for whom they were created.

H. Conclusion: Right now there is a growing retirement security crisis in the United States. There are a number of reasons for this. For one, the Baby Boomer generation is beginning to retire. The Baby Boomers are one of the largest generational cohorts in history, so just

in absolute numbers there are more people of retirement age now than there have ever been before. Also, half of all workers do not have access to a retirement plan through their employer. These workers are accumulating next to nothing in retirement savings. Additionally, the value of Social Security benefits has eroded over time. Differences in life expectancy between high-income and low-income workers weakens the progressive benefit structure of Social Security. The Spanish philosopher George Santayana said that those who do not remember the past are doomed to repeat it. This is why we must look at the history of pensions in the United States. History clearly shows that providing workers with a secure and dignified retirement through a pension is good for workers, taxpayers, society and the economy. Amen.

This scholarly little brochure could easily become a trustee's "Bible."
Download at <http://ippfa.org/pensions-matter-source-nppc/>.

2. THREE QUARTERS OF STATE AND LOCAL GOVERNMENT WORKERS IN DB PLANS: According to the United States Bureau of Labor Statistics (<http://www.floridatrend.com>), in March, 2016, 75 percent of state and local government workers participated in defined benefit pension plans. Of these workers, 57 percent participated in frozen defined benefit pension plans or plans that are not open to new employees. For 98 percent of workers who participated in defined benefit plans, employee benefits are based on a percentage of their earnings during a specified number of years, usually at the end of

their careers. The other 2 percent of workers participated in cash balance plans, where employees are credited with a specified contribution and a rate of interest on the contribution; the benefits are provided as a lump sum and may be converted to an annuity. These data are from the National Compensation – Benefits program. To learn more, see [National Compensation Survey: Retirement Plan Provisions in State and Local Government in the United States, 2016](#).

Defined benefit pension plans provide employees with guaranteed retirement benefits based on benefit formulas. A participant's retirement age, length of service and preretirement earnings may affect the benefits received. For more comprehensions of benefits terms, see [National Compensation Survey: Glossary of Employee Benefit Terms](#).

3. ACTUARIAL INPUTS AND THE VALUATION OF PUBLIC PENSION LIABILITIES AND CONTRIBUTION REQUIREMENTS: A

SIMULATION APPROACH: A working paper from the Center for Retirement Research at Boston College, (<http://crr.bc.edu/working-papers/>), uses a simulated public pension system to examine the sensitivity of actuarial input changes on funding ratios and contribution requirements. We examine instantaneous and lagged effects, marginal and interactive effects, and effects under different funding conditions and demographic profiles. The findings emphasize the difficulty of conducting cross-sectional analyses of public pension systems and point to several important considerations for future research. The paper found that:

- Discount rates, salary growth rates, cost methods, and mortality tables all influence funding ratios and contribution requirements. Without considering these effects, comparisons of funding ratios across pension systems will produce biased results.
- The discount rate assumption is the most influential actuarial input on funding ratios and contribution requirements. We show that a plan can postpone required contributions by raising its discount rate assumption, but its funding condition deteriorates in the long run. In contrast, if a plan reduces its discount rate by one percentage point, and its investment returns continue at the level that was previously assumed, it will take approximately seven years for the funding ratio to return to its original level and an even longer time period for the ARC to return to its original level (though the exact length of time depends on investment returns and the baseline discount rate assumption).
- The effects of actuarial inputs greatly depend on plan characteristics such as demographic profiles and asset levels, and also interactions with other actuarial inputs. Because of the interactive effects, it is difficult to standardize funding ratios or pension obligations by only controlling for a single actuarial input. With better data on plan characteristics (such as information on mortality tables and age distributions), simulations could be used to standardize pension liabilities. In the absence of that information, improved consistency in

financial reporting (such as requiring a single cost method) is an effective way to facilitate better comparisons of financial conditions across pension plans.

The policy implications of the findings are

- The valuation (or measurement) of public pension liabilities and contribution requirements is highly sensitive to the choice of several actuarial assumptions, which should be considered when assessing the financial condition of public pension systems.
- The sensitivity of liability and contribution requirement valuations to actuarial assumptions and methods depends on the demographic profile of pension participants.
- Making more optimistic assumptions reduces the liability and contribution valuations in the short term, but, over time, more optimistic assumptions can have substantive and harmful effects on pension liabilities and contribution requirements.

WP #2017-4 (May 2017)

4. ADDING ADDITIONAL SECURITY TO PROTECT WHAT IS IMPORTANT TO YOU: Social Security continues to evaluate and improve how we protect what is important to you. We take this

responsibility seriously, and we have a robust cyber-security program in place to help protect the personal information you entrust to us. Adding additional security measures to safeguard your personal information — but making them easy to use — is a vital part of keeping you safe and secure. Beginning June 10, 2017, we will use a second method to check the identification of [*my Social Security*](#) account holders when they register or sign in. This is in addition to the first layer of security, a username and password. Right now, you do not have to do anything for this new process. But you may want to [sign in to your account](#) to make sure you remember your username and password. Then, when you sign in on or after June 10, you will be able to choose either your cell phone or your email address as your second identification method. Using two ways to identify you when you log on will help better protect your account from unauthorized use and potential identity fraud. Since [*my Social Security*](#) became available in May 2012, more than 30 million people have created an account. We have always offered this second layer of protection, but only for customers who opted to use it. Last summer, we added a second way for us to check your identity when you registered or signed in to [*my Social Security*](#). However, at that time, we only allowed the use of a cell phone as your second identification method. We listened to your concerns, and beginning on June 10, you can choose either your cell phone or your email address as the second way for us to identify you. Since an email address is already required to use [*my Social Security*](#), everyone can continue to benefit from the features [*my Social Security*](#) provides. We are committed to

using the best technologies and standards available to protect our customers' data. This new security advancement is just one of the ways we are ensuring the safety of the resources entrusted to us. If you plan to select email as your second method, you can ensure that the one-time security code email does not go into your spam or junk folder by adding NO-REPLY@ssa.gov to your contact list. In addition to these security enhancements, we will also upgrade the look and feel of [my Social Security](#), in an effort to create an enhanced customer experience. The [my Social Security](#) portal will automatically adjust to the size of the screen and kind of device you are using — such as a tablet, smart phone, or computer. No matter what type of device you choose, you will have full, easy-to-use access to your personal [my Social Security](#) account. Our new [my Social Security](#) design puts you in control — whether you are using a computer, smart phone, or tablet.

5. NEARLY ONE IN FOUR AMERICANS' DRINKING WATER COMES FROM UNTESTED OR CONTAMINATED SYSTEMS: 77 million people — roughly a quarter of the U.S. population — spread across all 50 states were served by water systems reporting violations of the Safe Drinking Water Act in 2015, according to a [report](#) issued by the Natural Resources Defense Council (NRDC). The offenses ranged from arsenic to nitrate contamination, and included often-serious failures to test or report contamination levels. A new threat to the nation's water supplies comes in the form of dramatic cuts to the Environmental Protection Agency's 2018 budget—including programs

designed to safeguard our nation’s drinking water—despite President Trump’s recognition that “crystal clear water” is vitally important to the country. America is facing a nationwide drinking water crisis that goes well beyond lead contamination. The problem is two-fold: there is no cop on the beat enforcing our drinking water laws, and we are living on borrowed time with our ancient, deteriorating water infrastructure. We take it for granted that when we turn on our kitchen tap, the water will be safe and healthy, but we have a long way to go before that is reality across our country. *Threats on Tap: Widespread Violations Highlight Need for Investment in Water Infrastructure and Protections* found nearly 80,000 violations impacting drinking water systems in every state, but under-reporting and lax enforcement could mean the number of violations is much higher. Very small systems found in rural or sparsely populated areas account for more than half of all health-based violations, and nearly 70 percent of all violations. The report found the top five states with the most offenses based on population were

- Texas
- Florida
- Pennsylvania
- New Jersey
- Georgia

The NRDC recommends that the nation must:

- **Improve water infrastructure and modernize drinking water treatment plants.** This includes removing the 6 million to 10 million lead service lines across the country.
- **Increase funding for water infrastructure to protect health and create good jobs.** Congress should increase water infrastructure funding, which will also create millions of well-paid jobs fixing the nation's water system.
- **Strengthen and enforce existing regulations, and establish new ones.** Many contaminants found in drinking water – including pharmaceuticals and industrial chemicals – are not regulated, leaving everyone with potentially unsafe drinking water.
- **Develop a more robust testing system for drinking water contaminants.**

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

7. CRAZY STATE LAWS: *Good Housekeeping* reminds us that there are crazy laws in every state. In the **State of Maine** it is illegal to park in front of Dunkin' Donuts. You *donut* even know how much the town of South Berwick, Maine, loves its Dunkin' Donuts coffee. This law was enacted because the coffee and donut chain is a hot-spot

and the parking lot can turn into a mega traffic jam. Talk about a caffeine rush!

8. ZEN PROVEN TEACHINGS TO LIVE BY: Don't be irreplaceable. If you can't be replaced, you can't be promoted.

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

10. OLD CEMETERIES & EPITAPHS: A truly happy person is one who can enjoy the scenery on a detour and one who can enjoy browsing old cemeteries. For example, a cemetery in In a Uniontown, Pennsylvania, cemetery reads: Here lies the body of Jonathan Blake, stepped on the gas instead of the brake.

11. TODAY IN HISTORY: On this day in 1973 Senate Watergate Committee begins its hearings.

12. 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.

13. 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>.

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