



CYPEN & CYPEN

NEWSLETTER

for

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

1. PUBLIC PENSIONS CAN MEET THEIR OBLIGATIONS:

Full funding of public pensions is one of the most hotly debated subjects in state legislatures across the nation. It is generally accepted that public pensions should aim to be 100 percent funded. However, does full funding actually relate to the ability of a pension plan to pay benefits each year? A new report from NCPERS ([See C&C Newsletter for December 7, 2017, Item 1](#)), sheds some light on this question. The NCPERS report looks back on the past quarter-century's data from the annual survey of

public pensions conducted by the U.S. Census Bureau. The report examines only state pension plans as the Census Bureau does not collect data on local pension plans. The report then compares the difference between total contributions and investment earnings and benefit payments in a given year. It finds that pension funds have received enough revenue to meet their benefit obligations in every year except for four (2002, 2008, 2009, 2012), and that in those years the fund had enough assets built up in reserve that it was still able to pay full benefits. Public pensions today do not operate on a “pay-as-you-go” basis as many did in the past. A “pay-as-you-go” plan simply pays the full benefit amounts owed in a given year, typically with money appropriated directly from the state budget. In public pension plans today, workers and their employers each contribute a certain amount each year. These contributions are then invested by the staff of the pension fund. It is this combination of employee and employer contributions and investment earnings that pays the benefits that are owed to retired workers. In a given year, however, the amount of money contributed and earned through investments typically exceeds what is actually paid out in benefits that year. NCPERS refers to this as a “cushion.” Because of these “cushions” public pensions accumulate assets over time. This enables them still to pay benefits in years- such as 2008 and 2009 during the Great Recession-- when the combination of contributions and investment earnings is less than the amount owed in benefits. Funded ratio is an important measure to consider when examining the health of a public pension plan, but it is only one measure. NCPERS argues that an obsessive focus on this one measure distorts the larger picture of the health of a pension plan. Analysis suggests that pension funds can continue to meet their benefit obligations in perpetuity, regardless of their current funding levels. This is because there are usually more good years than bad years as far as investment returns are concerned, and good years allow pension funds to build up a cushion that can cover the shortfall during recession years.

2. THE 401(k), WHICH CHANGED HOW WE SAVE FOR RETIREMENT, TURNS 40:

The 401(k) plan may be as integral to retirement in America as Social Security and Medicare, but it was not conceived as a cornerstone of retirees' financial security. In 1978, the provision was inserted into the Internal Revenue Code to clarify that employees who invested a portion of their salary in company profit-sharing plans could defer taxes on the money. That led a handful of large companies to offer 401(k) plans to senior executives who wanted to supplement their pensions. By the mid-1980s, companies began to see the

advantages of abandoning traditional pensions entirely and replacing them with 401(k) plans. Companies no longer had to put aside enough money to cover lifetime payments to retired employees. And 401(k) plans shifted investment risk from employers to plan participants. The more than 54 million participants in 401(k) plans today hold about \$5.1 trillion in assets, according to the Investment Company Institute. The plans cost the government more than \$115 billion a year in tax revenues, but a proposal by Republican lawmakers to cap pretax contributions at \$2,400 a year was shelved following objections from the financial services industry. At first, employees embraced 401(k) plans, too. The 18-year bull market that began in 1982 led to healthy growth in their portfolios. And unlike traditional pensions, which are typically based on an employee's salary and years of service, 401(k)s give participants more flexibility to choose how much to save starting a year or less after they join a company. Plus, employees can change jobs and take the money with them. But as 401(k) plans became the primary source of retirement savings for millions of people, problems began to emerge. Some plans were riddled with high fees and subpar investment options. Forced to manage their own portfolios, many novice investors made poor investment decisions. More troubling, many workers did not bother to sign up, or they cashed out when they changed jobs. The financial services industry, which has reaped a windfall from the growth of 401(k) plans, says many of those problems have been solved. Average expenses fell from 1.02 percent of 401(k) assets in 2009 to 0.97 percent in 2014, according to a 2016 study by the Investment Company Institute and Brightscope, which rates 401(k) plans. Automatic enrollment has led to an increase in participation, particularly among millennials. Meanwhile, the rapid growth of target-date funds has simplified investing choices. These funds allocate investments in stocks and bonds based on your expected retirement date. The investment mix gradually becomes more conservative as you get closer to retirement. Target-date funds eliminate the paralysis that often sets in when investors are faced with too many choices.

3. THE MONEY MISTAKES THAT COULD RUIN YOUR RETIREMENT:

If you make this mistake, you face almost a 60% chance of running out of cash during retirement. More than 40% of pre-retirees say running out of money during retirement is their greatest fear, and six in 10 older Americans are actually more afraid of spending their retirement stash than they are of dying. To avoid running out of cash, it is important to save as much as possible for retirement. It is also important to avoid mistakes that could

undermine your efforts at financial security – like these three big blunders that could ruin your retirement, according to *The Motley Fool*.

Borrowing against your 401(k)

If you have high-interest debt or a financial emergency, your 401(k) balance may look like a nice source of funds to tap into. Unfortunately, taking a 401(k) loan is a risky gamble, because the entire unpaid loan balance becomes taxable if you cannot pay back the loan on time. The price for failing to repay a 401(k) on time can be devastatingly high: You will owe state taxes, federal taxes and a 10% withdrawal penalty on the outstanding balance. If you still owe \$10,000 at the end of the repayment period, and you have to pay a 25% federal tax, an 8% state tax and a 10% penalty, you will pay a total of \$4,300 in taxes. You may plan to pay back your loan and avoid the tax consequences, but if you leave your job for any reason, then you will suddenly have a narrow time frame -- usually around 60 days -- to repay the entire 401(k) loan. If you unexpectedly find yourself in the unemployment line, then you do not want to be forced to pay back a huge sum of money in order to avoid a big tax penalty. Even if everything goes right and you pay back your loan on time, you will still miss out on the investment gains you would have made by leaving your money invested -- which could be substantial if the market is doing well. And when you repay the money you borrowed from your 401(k), you repay it with after-tax dollars as opposed to pre-tax contributions -- but you are still taxed on withdrawals as a senior. In other words, you will be double-taxed on the amount paid back. In the worst-case scenario where you never repay the cash at all, between the tax penalties and the forgone capital gains, your \$10,000 loan could cost you over \$40,000 over the course of 20 years (assuming your portfolio earned 7% per year). It is easy to see why a mistake like borrowing from your 401(k) could be a recipe for disaster.

Cosigning for your kids' student loans

As a parent, you want what is best for your kids. Unfortunately, if you help your children out by cosigning for student loans, you could put yourself at serious financial risk. The problem is that if your kids cannot pay back student loans, the responsibility will fall on your shoulders. And this possibility is not all that remote: 11.5% of borrowers who began repayment Oct 1, 2013 were in default three years later, according to the U.S. Department

of Education. Even if you think your kids are too responsible to default, if they suffer a job loss or pass away, you could become responsible for repayment depending upon the type of loan. If you cannot afford payments, the government could make you pay anyway. The government collected \$171 million on defaulted student loan debt by reducing Social Security payments in 2015. When the government garnishes Social Security to collect student loan debt, it has serious financial consequences. In the past decade, the number of seniors whose Social Security payments were reduced below the poverty level by garnishments due to unpaid student loan interest rose from 8,300 to 67,300. Having your Social Security benefits garnished, or being forced to withdraw a huge sum of money from your retirement accounts to pay off an unpaid student loan, is a surefire recipe for financial hardship for a senior.

Retiring too early

Because of historically low bond rates and Americans' longer life spans, many longstanding ideas about retirement -- like the assumption that you can withdraw 4% or more from your retirement accounts each year without running out of money -- no longer apply. In fact, in 2013 researchers from The American College and Morningstar found that a senior following the 4% rule stood a 57% chance of running out of cash when returns were calculated based on current rates. Retiree spending falls into predictable patterns. Retirees spend more during early retirement, when they are healthy enough to travel and indulge their hobbies. They spend less during the middle of retirement as their health declines and energy wanes, and in the late stage of retirement they spend more as costly health issues arise. This means that if you exhaust your savings, you are likely to be short on cash at a time when you are too old to work. To avoid this predicament, it is imperative you accurately calculate how much you will need for retirement and how much you can safely withdraw without putting your future at risk. If your projected withdrawals do not provide enough money to cover your expected costs, think about working longer or lowering your costs of living.

4. CAPPING OFF A HISTORIC YEAR, STUDY REVEALS 2018 INVESTOR

RESOLUTIONS:

E*TRADE Financial Corporation announced results from the most recent wave of *StreetWise*, the quarterly tracking study of experienced investors. Results reveal that the

top resolutions among surveyed investors are to:

Increase retirement plan contributions.

Up six percentage points from last year, 40 percent of investors want to allocate more to their retirement plan in 2018.

Adjust asset allocations.

Nearly 40 percent of investors expressed a desire to tweak their asset mix to reflect changing market conditions, which is consistent with last year.

Leverage educational resources.

35 percent of investors surveyed want to learn more about investing, trading and the markets, which is consistent with last year.

The market in 2017 exceeded many investor expectations by continually reaching higher highs, pressing forward amid shifting political and social agendas, and significant Fed moves. As the sun rises on 2018, it is no surprise that investors are more likely to be engaging with the market through retirement accounts given the bull market's continued run. With a pro-business agenda in Congress, strong corporate earnings, and the economy buzzing, investors are clearly hoping this bull has some more room to run.

5. MORE THAN THREE QUARTERS OF AMERICANS ARE LIKELY TO SET FINANCIAL GOALS IN 2018:

As 2017 comes to an end, a study by Lincoln Financial Group shows that 77 percent of Americans are very likely or somewhat likely to set financial goals in 2018 — more than double the 34 percent who set specific financial goals in 2017. Additionally, 83 percent of Americans who set a specific financial goal in 2017 feel better about their finances now than they did at the beginning of the year. According to the Lincoln study, *Financial Focus: Goals and Reflections of Today's Consumer*, simply making a New Year's resolution about finances may lead to increased confidence in a consumer's financial situation even if they do not reach their goal. Sixty-nine percent of those who set a goal but did not accomplish it say that they feel better about their finances compared to 64 percent of those with no financial goal. "Every journey begins with a first step, and when it comes to

finances the first step is setting a goal,” said Regina Beatty CFP ,CBEC , CRPC , a private wealth strategist with Mosaic Wealth Consulting and a registered representative with Lincoln Financial Advisors. “Regardless of your level of wealth, just making a financial resolution at the beginning of the year can inspire confidence and increase awareness of budgeting, saving and planning for the future.” Financial resolutions can be as simple as setting a goal for an amount to save in 2018, making a monthly budget, creating or adding to an emergency savings fund, increasing contributions to retirement plans and reviewing investment performance and insurance needs. To be successful, she recommends talking with a financial advisor, who can help create a financial roadmap by setting realistic goals, and help keep savers on track over the course of the year. As they are making resolutions, individuals can also utilize online calculators and planning tools like those offered on Lincoln’s website. The study also found that 65 percent of Americans are likely to make a New Year’s resolution of some type in 2018, up from the 54 percent who made one in 2017. The most common categories of resolutions are fitness and weight loss, followed by happiness focused resolutions and then finances and career improvement. As age increases, the likelihood of making a resolution decreases -- 84 percent of Millennials plan to make a New Year’s resolution in the coming year compared to 71 percent of Gen Xers, 51 percent of Baby Boomers and 43 percent of Goldens. Americans are also feeling better about their finances than they did at the beginning of the year, and even more expect their finances to improve in 2018 according to the study. Overall 74 percent of Americans feel better about their finances now compared to the beginning of 2017 and 84 percent expect their finances will improve in 2018.

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. CLEVER WORDS:

Arbitrator: A cook who leaves Arby’s to work at McDonald’s

8. INSPIRATIONAL QUOTE:

Whatever the mind of a man can conceive and believe, it can achieve. –Napoleon Hill

9. LEXOPHILES:

When a clock is hungry it goes back for seconds.

10. TODAY IN HISTORY:

On this day in 1999, for the first time since Charlemagne's reign in the ninth century, Europe is united with a common currency when the "euro" debuts as a financial unit in corporate and investment markets.

11. 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.

12. 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>.

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