



# CYPEN & CYPEN

## NEWSLETTER

for

## March 15, 2018

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

### **1. WALL STREET, NOT COPS AND FIREFIGHTERS, CAUSED PENSION CRISES:**

If there is one thing the debate over public employees' pensions has taught us, it is that California needs to invest more in mathematics instruction. When The Sacramento *Bee* editorial board (["The pension nightmare for California's cities is getting scarier,"](#) Feb. 13) and city officials wag their fingers of blame at firefighters, teachers, police officers and state pension systems that have yielded 7 percent returns in the long run, it is clear there

is a fundamental misunderstanding of the numbers. First, clearly, the state pension systems are facing challenges. In 1999, when Senate Bill 400 was passed with strong bipartisan support, CalPERS was 137 percent funded and the state was in the midst of an economic boom. Contributions by state and public agencies had dropped to near zero, while taxpayers saved billions of dollars by making lower or no contributions, while public employees continued to make full contributions towards their retirement. Then, due to the fraud and abuse by Wall Street bankers, the worst recession since the Great Depression hit and investors across the globe watched as trillions of dollars in asset values were wiped out. CalPERS lost \$69 billion in the first year; over the next two years, its funded status dropped by 40 percent. If it were not for the Great Recession, SB 400 benefits would have been funded for 138 years. That is why it is unfair to criticize hard-working public employees and their pensions, while union critics give Wall Street a free pass. Also, the editorial board forgets that pensions keep good people on the job who benefit our communities. Whether it is when a police officer gets shot at, or a firefighter battles a wildfire, pensions offer peace of mind in case of disability or early retirement. As a public employee, I can assure you I am not sailing on yachts in the Caribbean and drinking expensive champagne. Retired public employees are in our communities, where our pensions support the local economy and jobs to the tune of more than \$35 billion. Author, Wayne Harris is systems administrator for Woodland Joint Unified School District and a member of Californians for Retirement Security, an advocacy group for public employees and retirees.

## **2. DOOM AND GLOOM OVER PERA UNWARRANTED:**

Kenneth Nova is a retired teacher and recipient of Colorado Public Employees' Retirement Association (PERA) benefits that he earned during my 28 years of service credit. When Nova read [the Denver Post article](#), "Warnings ignored: Why PERA is barreling toward its second funding crisis in a decade," he heard the voice of people like Walker Stapleton who constantly raise the specter of gloom and doom about PERA and attempt to drown out common sense proposals that address the issues of people living longer and the investment percentage being adjusted. For example, year after year, Republican legislators try to change PERA to a defined-contribution system. In 2015, studies showed Senate Bill 080, a bill allowing all employees in a PERA plan to choose defined contribution, would result in \$4.2 billion additional unfunded liability to the system over 30

years! Consultants from Gabriel Roeder Smith stated, "Individually directed defined contribution plans do not earn investment returns to the same degree as large, professionally managed defined benefit plans." Teachers in Colorado work for average salaries that trail most other states. Over the years, Nova paid hundreds of thousands of dollars in monthly payments into PERA, with the expectation of deferred income in the form of a defined pension. Federal laws reduce the Social Security benefits earned by two-thirds, so people rely on PERA. They appreciate and rely upon defined benefits, where people can budget around known checks received each month that they earned. Local businesses appreciate when PERA dollars are spent in the community. More than 98,000 Colorado PERA recipients pump more than \$6 billion into Colorado's economy. Proposals forwarded by people like Stapleton and the *Denver Post* editors, when the PERA board and recipients staunchly oppose them, surely should make them wonder.

### **3. TWO OF THE 100 LARGEST US CLASS ACTION SETTLEMENTS SINCE PASSAGE OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 WERE APPROVED IN 2017:**

Securities Class Action Services ("SCAS") released its latest issue of [The Top 100 U.S. Class Action Settlements of All-Time](#), which identifies the largest securities class actions settlements by total settlement amount as of year-end 2017. The Top 100 report is based upon historical settlement data from SCAS's proprietary database and a review of 162 court approved settlements during 2017. Collectively, 2017 delivered \$2.1 billion in settlement funds for distribution. While the volume of settlements greater than \$100 million was low, new cases filed in 2017 were significantly higher than the previous year. To learn more about these trends and the Top 100 U.S. class action settlements, [download the full report](#).

### **4. SEGAL GROUP WARNS DB PLAN SPONSORS NOT TO STRAY FROM MORTALITY ASSUMPTIONS:**

The Segal Group notes that the latest federal government report from the National Center for Health Statistics (NCHS) shows that life expectancy at birth declined for the second consecutive year, which could tempt defined benefit (DB) plan sponsors to conclude the latest data are good news for pension plan costs, according to Segal. However, [the firm notes](#) that DB plan sponsors should look beyond the headlines, as life expectancy

continues to improve for retirement-age Americans. “Recent mortality rates observed for the older population continue to support expected improvements in projected life expectancy for this age group, which drives pension costs,” says Eli Greenblum, chief actuary for The Segal Group. “It is important for actuaries for all types of pension plans, including those who work with multiemployer and public-sector plans, not to reverse expectations for mortality improvement in response to the latest data.” According to the NCHS, between 2015 and 2016, death rates increased significantly for the under-45 age groups studied. In contrast, death rates decreased for the post-65 retirement-age groups. In fact, researchers from the Society of Actuaries (SOA) [measured an ‘anomaly’](#) in mortality rate measures for 2016. SOA finds the overall age adjusted mortality rate for both genders from all causes of death decreased by 0.6% in 2016. “This decrease in overall mortality may seem to run counter to the [Center for Disease Control’s] CDC’s report that life expectancy at birth declined 0.1 years in 2016,” the researchers note. “Generally, a decrease in the mortality rate would be expected to produce an increase in life expectancy. However, both figures are correct. In this respect, 2016 was a somewhat anomalous year.” When the Society of Actuaries (SOA) [released its annually-updated mortality improvement scale](#) for pension plans, MP-2016, incorporating three additional years of Social Security Administration (SSA) data on U.S. population mortality, it suggested U.S. mortality continues to improve, but at a slower average rate of improvement than previous years, which may decrease pension plan obligations slightly. “As additional experience emerges, there may be refinements necessary in actuaries’ assumptions for pension plans, but they should be based on longer-term trends. We should be cautious about setting long-term assumptions based on shorter-term trends, even when those trends last a decade,” warns Jeff Litwin, Segal Group’s corporate research actuary.

##### **5. WILL THE FINANCIAL FRAGILITY OF RETIREES INCREASE?:**

The elderly have long been seen as financially fragile, meaning that they may be ill-equipped to absorb a financial shock. The key reason is that, once retired, they have little ability to increase their income compared to working households. Going forward, retirees will get less of their income from Social Security and traditional pensions and more from financial savings in 401(k)s. Having these savings gives them greater flexibility to respond to shocks. But tapping the nest egg comes at the cost of having less to cover ongoing

expenses. The increased dependence on financial assets also introduces new sources of risk – that households accumulate too little and draw out too little to cushion shocks and that their finances are increasingly exposed to market downturns. This brief reviews studies by the Social Security Administration’s Retirement Research Consortium and others that address how the growing dependence on household savings affects the financial fragility of the elderly. The discussion proceeds as follows. The first section examines the share of expenditures that a typical elderly household devotes to basic needs. The second section reviews evidence on the ability of today’s elderly to absorb two major shocks: a spike in medical expenses and a decline in income when widowed. The third section addresses the increased dependence of tomorrow’s elderly on financial assets, the sufficiency of these assets, and the effects on their ability to absorb shocks. The final section concludes that most current retirees can absorb a shock. However, future retirees are more likely to experience financial fragility unless they reduce their fixed expenses or draw increased income from their assets.

Conclusion: the research reviewed in this brief suggests that while a small share of today’s retirees are financially fragile, most appear able to absorb a financial shock, at least for a time, without a substantial reduction in their standard of living. For future retirees, however, retirement income replacement rates are projected to decline due to inadequate savings and the limited income that safe withdrawal rates provide, reducing the cushion between their incomes and fixed expenses. If households choose to hold a significant portion of their savings in equities to increase the income their savings provide, they will be more exposed to sharp market downturns that arrive early in retirement. The most effective response for households approaching retirement is to increase their retirement income and reduce their fixed expenses. Working longer, annuitizing wealth and taking out a reverse mortgage would increase retirement income. Downsizing is the most effective way to reduce fixed expenses, and could also increase the household’s financial assets. While many individuals are already working somewhat longer, retirees rarely annuitize, downsize, or take out a reverse mortgage. Whether the prospect of increased financial fragility leads them to change their behavior remains to be seen.

## **6. 100 MINUS AGE: THE ALLOCATION RULE THAT COULD PUT RETIREES AT RISK:**

Is determining your investment allocation by using the "100 minus age" rule a smart approach to investing your retirement money? Research indicates this rule of thumb may harm you more than it helps. What is the "100 Minus Age" Rule? When you invest your money, the decision you make that will have the most impact on your results is how much you keep in [stocks vs. bonds](#). Over the years many rules of thumb have developed in an attempt to provide guidance on this decision. One such popular rule is the "100 minus age" rule, which says you should take 100 and subtract your age: The result is the percentage of your assets to allocate to stocks (also referred to as equities). Using this rule, at 40 you would have a 60% allocation to stocks; by age 65, you would have reduced your allocation to stocks to 35%. In technical terms this is referred to as a "declining equity glidepath". Each year (or more likely every few years) you would decrease your allocation to stocks, thus reducing the volatility and risk level of your investment portfolio.

#### Practical Problems With This Rule

The problem with this rule is it is not coordinated with your financial goals in any way. Investing decisions should be based on the job your money needs to do for you. If you are currently 55, and not planning on taking withdrawals from your retirement accounts until you are [required to do so at age 70 ½](#), then your money has many more years to work for you before you will need to touch it. If you want your money to have the highest probability of earning a return in excess of 5% a year then having only 50% of those funds allocated to stocks may be too conservative based on your goals and time frame. On the other hand, you might be 62, and about to retire. In this situation many retirees will benefit from [delaying the start date](#) of their Social Security benefits and using retirement account withdrawals to fund living expenses until they reach age 70. In this case you may need to use a significant amount of your investment money in the next eight years, and perhaps a 38% allocation to stocks would be too high.

#### What the Research Shows

Academics have begun to conduct [retirement research](#) on how well a declining equity glide path (which is what the 100 minus age rule will deliver) performs compared to other options. Other options include using a static allocation approach, such as 60% stock/40% bonds with annual rebalancing, or using a rising equity glide path, where you enter retirement with a high allocation to bonds and spend those bonds while letting your stock

allocation grow. Research by Wade Pfau and Michael Kitces shows that in a poor stock market, such as what you might have experienced if you retired in 1966, the 100 minus age allocation approach delivered the worst outcome, leaving you out of money thirty years after retirement. Using a rising equity glidepath where you spend your bonds first delivered the best outcome. They also tested the outcome of these various allocation approaches over a strong stock market, such as what you might have experienced if you retired in 1982. In a strong stock market all three approaches left you in good shape with the static approach delivering the strongest ending account values and the rising equity glidepath approach leaving you with the lowest ending account values (which were still far more than you started with). The 100 minus age approach delivered results right in the middle of the other two options.

#### Plan for the Worst, Hope for the Best

When you retire, there is no way of knowing whether you will be entering a decade or two of strong stock market performance or not. It is best to build your allocation plan so that it works based on a worst-case outcome. As such, the 100 minus age approach does not appear to be the best allocation approach to use in retirement as it does not fare well under poor stock market conditions. In lieu of allocating portfolios this way, retirees should consider exactly the opposite approach: Retiring with a higher allocation to bonds that can be intentionally spent, while leaving the equity portion alone to grow. This would most likely result in a gradual increase to your allocation to equities throughout retirement. Dana Anspach brought us this interesting piece.

#### **7. CONGRESSIONAL RETIREMENT REPORT CALLS FOR MORE ACTION:**

Congress has to do a lot more to improve retirement security, said a report issued Wednesday by Democrats on the congressional Joint Economic Committee. In the report, [Retirement Security in Peril](#), the members call for modernizing Social Security and by raising the payroll tax cap and expanding benefits for some people, expanding access to defined contribution plans by allowing more open multiple employer plans and offering start-up credits for small businesses to help motivate them to offer retirement plans, among other steps. "It is also important that policymakers secure the long-term stability of the Pension Benefit Guaranty Corp.," the report said. "Congress has taken the approach of issuing short-term fixes for the program, and it should work to create a long-term

solution to ensure that the PBGC's protections continue to cover workers' retirement benefits," which could include new ideas like the proposed Butch Lewis Act that would create a federal loan program for struggling plans. "Finally, there needs to be new ways to entice employers and state and local governments to provide access to high-benefit, low-cost retirement plans," the report said. The report was overseen by ranking committee member Sen. Martin Heinrich, D-N.M., who said in a statement that "Congress must take action to make certain that older Americans do not face an impending retirement crisis." Kudo's to reporter Hazel Bradford for this piece.

**8. 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.

**9. CLEVER WORDS:**

Sudafed: Brought litigation against a government official.

**10. INSPIRATIONAL QUOTE:**

Either you run the day, or the day runs you. – Jim Rohn

**11. LEXOPHILES:**

He broke into song because he could not find the key.

**12. TODAY IN HISTORY:**

On this day in 44 B.C., Julius Caesar is stabbed to death by Brutus, Cassius and several other Roman senators on the Ides of March in Rome.

**13. THINK YOU KNOW EVERYTHING?:**

In England, the Speaker of the House is not allowed to speak.

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