



CYPEN & CYPEN

NEWSLETTER

for

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

1. THE REAL REASON THE INVESTOR CLASS HATES PENSIONS:

No issue in America today better illustrates the divergent interests of working Americans and the 1 percent than pension reform. Substantial empirical evidence shows that America's favored retirement vehicle — the 401(k), recently renounced by its own inventors — is grossly inadequate and will leave tens of millions of Americans with insufficient retirement assets. And yet states and cities are busy converting traditional

pensions into these failing 401(k)s or equivalents, to the great benefit of money managers and the finance class. Advocates of pension “reform” — which really means cutting or eliminating traditional pension funds — will tell you that such funds are a big drain on state and local budgets, since, as defined-benefit programs, they are obligated to pay workers a defined amount in their retirement. But that is largely a question of political priorities; underfunded pensions are the result of, well, decades of underfunding pensions. The real reason for the attack on pensions goes deeper, and exposes the great and growing rift between America’s economic elite and everyone else. Consider how we 401(k) holders behave as investors. How many of us thought to sue Wells Fargo after the Consumer Financial Protection Bureau revealed that the bank had created millions of fake credit card and bank accounts? Or to push our fund managers to do so for us? How many of us call up our fund managers after a quarter, a year or a decade in which we underperformed the Standard & Poor’s 500-stock index to renegotiate our fees? Or even to switch managers? How many of us even know how our funds performed relative to the S.&P. 500? The answer to all of these questions is a number very close to zero. We 401(k) holders are the world’s ideal source of capital. We let ourselves be charged high fees that we do not understand, we accept poor returns quarter after quarter, we never sue to enforce our rights, we never vote as shareholders and we never tell our investment managers how we think they ought to vote. We are beyond passive; we are supine. At bottom, the problem is structural. We are to our investees and investment managers what nonunionized, “right to work” workers are to their employers: alone and devoid of leverage to negotiate. That stands in sharp contrast to traditional pensions, which, like unions, are collective and centrally managed. For example, the nation’s largest traditional pension, the California Public Employees’ Retirement System, known as Calpers, has 1.9 million members and over \$300 billion in assets. When it calls up an investment manager to complain about performance, or to dump that manager, or when it calls a lawyer to sue for fraud, that catches the attention of corporate managers, of hedge funds, of private equity funds. That is why they succeed where we fail. All of us benefit from their successes, which raise the value of companies we own. Our mutual funds could do the same for us, if they wanted to, but they do not. Despite important recent gestures towards activism, they have trailed far behind pension fund activists, and will continue to do so. They do not want to challenge the compensation, reelection or legal judgment of the same corporate managers from whom they hope to win the right to manage our 401(k) money in the first place. Not true

for public pension funds. In just the past few years, pension funds (private pension funds have been almost completely eliminated) have radically reformed the role of shareholder opinion in executive compensation, successfully lobbying for the inclusion of “say-on-pay” votes in the Dodd-Frank financial reform legislation and for mandatory disclosure of the chief executive/worker pay ratio. Pensions have also played the most prominent role in vivifying corporate voting, long an oxymoron. Because of a campaign run by New York City’s pension funds and others, hundreds of companies now offer significant, long-term shareholders a meaningful opportunity to put their own board candidates on a corporate ballot. Pension funds have similarly backed the shift from plurality- to majority-voting rules, and they have pushed to destagger corporate boards so that the entire board is up for election every election cycle, rather than just one-third per cycle, a move that increases a board’s accountability. Traditional pension funds have also brought almost all of the most successful shareholder lawsuits, from the suits against Enron and Worldcom to the one against Wells Fargo. Nevertheless, almost everywhere we look, these pensions are under attack. Entities like the Koch brothers’ Americans for Prosperity, the Laura and John Arnold Foundation (John Arnold made billions at Enron), the American Legislative Exchange Council and their allies are engaged in a multifaceted, multistate campaign to gut traditional pensions like Calpers. This relentless, well-funded attack has taken every form of political advocacy available. It ranges from campaign contributions to ballot initiatives to model legislation to lobbying to lawsuits to financing academic and judicial conferences. One estimate suggests that Mr. Arnold’s foundation alone has spent \$50 million on this issue, an estimate Mr. Arnold vigorously disputes. The primary goal of the attack is to convert these traditional pensions into 401(k)s. The justification is that these pensions are in crisis. The familiar claim is that states and municipalities face unsustainable pension obligations that will crowd out other government spending and lead to higher taxes. Therefore, traditional pensions, which guarantee retirement payments to workers — leaving states and cities on the hook — must be replaced by 401(k)s, which offer no such guarantee. Though the mainstream media have mostly taken the crisis claim at face value, economists and actuaries debate its extent and even its existence. Since the Great Recession, 49 states have reformed pensions to make them more sustainable, increasing employee contributions and reducing benefits. Wherever one stands on the underfunding question, plenty of options short of converting pensions to 401(k)s exist, including ones that would preserve some collective shareholder voice. But these are rarely

considered. Why? We cannot understand the drive toward pension “reform” by looking only at the liability side of the balance sheet: how much we owe workers and what it will cost to pay them. We must look at the asset side, too: how these pensions invest their money, and their ability to exercise shareholder voice that the rest of us lack. If the Kochs and their allies succeed in smashing and scattering these last remaining pension funds into millions of 401(k)s, they will do more than just undermine the retirement security of millions of Americans. They will silence their economic voice. The pension reform drive should be understood, at least in part, as a campaign of economic voter suppression. And it is coming, soon, to a jurisdiction near you, if it isn’t there already. David Webber, a law professional at Boston University, is the author of this piece. We believe the author has hit it right on the head.

2. INVESTOR COALITION FILES PROPOSALS AT 50-PLUS COMPANIES ON LOBBYING ACTIVITIES:

A coalition of about 74 institutional and individual investors, including some public pension funds, filed shareholder proposals at more than 50 companies in the U.S. and Canada this proxy season, requesting reports on their federal and state lobbying activities, said a news release from the American Federation of State, County and Municipal Employees, says Meaghan Kilroy. The shareholder proposals request information on federal and state lobbying payments, payments to trade associations used for lobbying, and payments to any tax-exempt organization that writes and endorses model legislation. On the reason for the proposals, AFSCME said that investors are concerned lobbying can pose reputational risks if it contradicts a company's publicly stated positions. Undisclosed payments for trade association lobbying is one area of concern for coalition members. In some cases, a trade association may actively lobby for issues that are contrary to a company's public statement or values. Investors advancing these resolutions believe management needs to review trade association memberships to assess whether a trade association is accurately representing the company's interests and policy positions and should have procedures in place to manage conflicts when a trade association's position strongly differs from the company on a priority issue, the release said. One area where corporate and trade association values may be misaligned is climate change. Many companies have programs to address climate change, yet are also members of the U.S. Chamber of Commerce, which has consistently opposed legislation and regulation to address climate change.

Since 2012, members of the coalition have filed more than 340 shareholder proposals on corporate lobbying, which have received more than 25% investor voting support on average. Companies targeted this proxy season include AbbVie, Alphabet, Aetna, BlackRock, AT&T, Boeing, Citigroup, Exxon Mobil and Goldman Sachs Group. Proposals have already been withdrawn at Atmos Energy, Encana, Duke Energy, Goodyear Tire & Rubber, Textron, SCANA and Travelers Cos. because those companies have taken steps to address investor concerns. At Walt Disney Co.'s annual meeting, about 37% of investors supported the coalition's proposal. The group's 2018 proposals have also already been voted on at Emerson Electric Co. and Tyson Foods, where they were supported by 39.6% and 12% of shareholders, respectively. More than \$3.3 billion total was spent on federal lobbying last year, with companies spending about \$2.6 billion. At the state level, companies spend more than \$1 billion annually on lobbying. Trade associations, meanwhile, spend more than \$100 million lobbying annually. The coalition's pension fund members include the \$209.1 billion New York State Common Retirement Fund; \$8 billion Rhode Island State Investment Commission,; and the \$4.8 billion Philadelphia Public Employees' Retirement System.

3. PLSA CONFERENCE SPEAKERS MAKE CASE THAT CLIMATE CHANGE IS LARGEST MACRO RISK:

According to Paulina Pielichata, climate change is possibly the biggest macro risk for pension funds in a post-quantitative easing environment, speakers warned at the Pensions and Lifetime Savings Association's annual conference in Edinburg. Speakers agreed that discussions about the impact of climate change on investments need to continue beyond listed equity and expand into other assets classes such as private credit and private equity. Despite the panel's conviction on the point, the audience, through a poll conducted at the beginning of the session, did not rank climate change as the biggest risk. The audience ranked macroeconomic risks as the top concern. "We have discussed climate risks associated with equity investments, but we need to broaden our horizon and extend it to credit markets, private equity and private credit investments," said Elizabeth Fernando, head of equities for the £60 billion (\$83 billion) Universities Superannuation Scheme. "We (also) need to expand (thinking about this) to real and infrastructure assets as extreme weather events affect migration patterns," she said. "Weather events are difficult for insurers" and "uncertain cost of insurance will be a risk to portfolios," she

warned. "Shopping malls we invest in could be worth nothing if populations move away from near-sea areas (and) begin to migrate due to rising sea levels," she said. Simon Lee, chief investment officer of the £10 billion Marks & Spencer Pension Scheme, agreed with Ms. Fernando, saying the industry needs to move the debate away from listed equity. "We need to think about sustainability so that there is business there to invest in the future. The business needs to be there in the future for me to invest in it." Regarding other risks, the panelists agreed that short-term market inflation expectations are risks pension funds need to watch, as are rising interest rates globally. David Adkins, head of investment strategy at the £40 billion Lloyds Banking Group Pension Fund, said: "Investors are looking at how often the (Federal Reserve) will increase rates this year. That could be a more dangerous risk if that feeds into the inflation expectation. If it starts to raise even 1% this could impact liabilities by some 10%." On a separate panel, Nick Clegg, former deputy prime minister of the U.K., said he expected the next source of risk in the system to be located outside of the banking sector as liquidity begins to come out of the monetary system. "It would be extremely surprising to see the next financial crisis to be coming from the same source," he said. "The banking system is now so tightly regulated." During his session on 10 years after the global financial crisis, Mr. Clegg said that because post-crisis regulations focused on banking, they pushed "finance, lending and money outside the banking system, and that could be where the next risks come from."

4. OKLAHOMA POLICE CIO UNDER INVESTIGATION FOR ALLEGED EMBEZZLEMENT:

According to a report from James Comtois, Steven Snyder, executive director and chief investment officer of the [Oklahoma Police Pension & Retirement System](#), is under investigation by the state's attorney general for allegedly embezzling operating funds. Mr. Snyder was allegedly "engaged in excessive travel for personal business and being reimbursed with state funds," said the search warrant used to seize the state-owned Apple iPad Air he was issued. The warrant further alleges that of the 21 travel claims that Mr. Snyder submitted for reimbursement from Feb. 7, 2015, through Sept. 29, 2017, nine of them — totaling \$26,265.35 — were "found to have been made surrounding Snyder's personal travel." In addition, Mr. Snyder allegedly emailed people he was meeting to ask them to bring portfolios or other documents to justify the trip as a business expense, according to the warrant. Mr. Snyder and retirement system Chairman W.B. Smith could

not be immediately reached for comment. The potential wrongdoing does not pertain to the system's \$2.2 billion plan assets, said a news release issued by the Oklahoma attorney general's office. "To be clear, there is no evidence suggesting law enforcement pensions have been compromised," said Oklahoma Attorney General Mike Hunter in the release. "I want to assure our law enforcement partners throughout the state and their families that my office will have their best interests in mind throughout this investigation." Ryan Perkins, retirement system vice chairman and Tulsa Police Department major, added in the release that the organization is aware of the allegations and is cooperating with the attorney general's investigation. "We respect the ongoing investigation by the attorney general's office," Mr. Perkins said in the news release. "Our organization takes these allegations seriously and will work with investigators to bring clarity to our members, who trust us to look out for them." The search warrant is available on the Oklahoma attorney general's [website](#).

5. PRIVATE EQUITY'S TRICK TO MAKE RETURNS LOOK BIGGER:

It is perhaps the most important number in [the private-equity world](#). It is also at risk of being massaged in a way that undermines the industry's credibility and adds dangers when a downturn comes, writes Paul J. Davies. The internal rate of return is the key performance metric published by private-equity firms. A percentage that measures annualized returns, the IRR is based on a complex set of numbers tied to fund cash flows. Investors use IRR to choose which funds to invest in. But the growing use of hidden borrowing, known as subscription-line or bridge financing, is flattering the IRR figures, some funds report. It works like this: As funds identify investments, they traditionally call on their investors, known as limited partners, to pony up the cash they committed to supply when the fund was put together. But instead of calling that cash as soon as an asset to buy is identified, the funds borrow money to make the investment, tapping investors' cash later. This began as a way simply to make capital calls more predictable for LPs, and in itself such borrowing does not boost a fund's cash profits. But crucially it shortens the time during which investors' cash is actually in the fund. When you shorten the apparent time it takes to generate a cash profit, that boosts the IRR—sometimes in a very big way. The trouble is, fund managers, investors and the consultants who advise them may not have an interest in rocking this boat: Internal rates of return are the key statistic that determines how much (and when) most of these people get paid. It also

makes a good impression, say, with a pension fund investor committee that oversees how money is allocated among bonds, stocks and private equity. But some investors are growing more worried about the damage that might be done by this borrowing. They fear first that it will increasingly distort returns data across the industry, making them less reliable. Potentially worse is the risk that funds will face in a cash crunch if markets turn, banks withdraw the financing and some investors cannot deliver their fund commitments, even after their money has in effect already been spent. Huge jumps in IRRs can occur when funds use bridge financing and resell investments quickly, says Oliver Gottschalg, a professor at HEC, a French business school, and head of research at Peracs, a consulting firm that analyzes private-equity returns. "For 80% of funds, short-term use of bridge finance lifts IRRs by less than a percentage point, but for a few, the IRR goes through the roof," he says. Prof. Gottschalg's analysis is based on cash-flow data from 149 fully mature funds that began investing between 2003 and 2006. He recalculated their IRRs to add in simulated use of bridge financing on the funds' first capital call for up to 360 days. Much of his work is based on bridge financing that lasts just 90 days. However, funds now regularly use it for six months or a year and some are pushing that to 18 months or more, investors say. The longer that funds hold investments without calling on investors' cash, the greater the boost to IRRs. So who are the worst offenders? It's hard to say because most private-equity firms do not disclose this financing other than to existing investors. And while investor bodies are working to improve transparency, the industrywide returns data from consultants like Cambridge Associates or Preqin cannot yet correct for the effects of financing. Nobody knows how important it is. There may already be an arms race under way as firms compete to show the best returns data. At a time when private-equity deals are being done at high valuations and some think a downturn in markets is already overdue, this is a growing, hidden financial risk.

6. TOP THINGS TO KNOW ABOUT DEDUCTING CHARITABLE CONTRIBUTIONS ON A 2017 TAX RETURN TAX:

Taxpayers who give money or goods to a charity may be able to claim a deduction on their 2017 federal tax return, which basically reduces the amount of their taxable income. Here are some important facts about charitable donations:

- **Qualified charities.** To receive a deduction, taxpayers must donate to a qualified charity. To check the status of a charity, use the IRS [Select Check](#) tool. Here are examples of things that taxpayers can't deduct:
 - Gifts to individuals
 - Donations to political organizations and candidates
- **Itemize deductions.** To deduct donations, taxpayers must file Form 1040 and itemize deductions using [Schedule A](#).
- **Benefit in return.** Taxpayers can only deduct the amount of their donation that exceeds the fair market value of the benefit received. If taxpayers get something in return for their donation, they may have to reduce their deduction. Examples of benefits include merchandise, meals and tickets to events.
- **Property donation.** If taxpayers give property instead of cash, they can normally only deduct the item's fair market value. Fair market value is generally the price they'd get for the property on the open market. Used clothing and household items donated must generally be in good condition or better. Special rules apply to cars, boats and other types of property donations.
- **Form to File.** Taxpayers file [Form 8283](#) for all non-cash gifts totaling more than \$500 for the year.
- **Proof of Donation.** If taxpayers donated cash or goods of \$250 or more, they must have a written statement from the charity. The statement must show:
 - Amount of the donation.
 - Description of any property given.
 - Whether the donor received any goods or services in exchange for the gift.

7. 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.

8. CLEVER WORDS:

Selfish: What the owner of a seafood store does.

9. INSPIRATIONAL QUOTE:

The only person you are destined to become is the person you decide to be. – Ralph Waldo Emerson

10. LEXOPHILES:

I thought I saw an eye doctor on an Alaskan island, but it turned out to be an optical Aleutian.

11. TODAY IN HISTORY:

On this day in 1999, the Dow Jones Industrial Average closes at 10006.78 - above the 10,000 mark for the first time ever.

12. THINK YOU KNOW EVERYTHING?:

On a Canadian two dollar bill, the flag flying over the Parliament building is an American flag.

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