



CYPEN & CYPEN
NEWSLETTER
for
October 18, 2018

Copyright, 1996-2018, all rights reserved
Stephen H. Cypen, Esq., Founding Editor
Robert D. Klausner, Esq., Senior Editor

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

1. SOCIAL SECURITY ANNOUNCES 2.8 PERCENT BENEFIT INCREASE FOR 2019:

Press Release

News Release

SOCIAL SECURITY

Social Security and Supplemental Security Income (SSI) benefits for more than 67 million Americans will increase 2.8 percent in 2019, the Social Security Administration announced today. The 2.8 percent cost-of-living adjustment (COLA) will begin with benefits payable to more than 62 million Social Security beneficiaries in January 2019. Increased payments to more than 8 million SSI beneficiaries will begin on December 31, 2018. (Note: some people receive both Social Security and SSI benefits). The Social Security Act ties the annual COLA to the increase in the Consumer Price Index as determined by the Department of Labor's Bureau of Labor Statistics. Some other adjustments that take effect in January of each year are based on the increase in average wages. Based on that increase, the maximum amount of earnings subject to the Social Security tax (taxable maximum) will increase to \$132,900 from \$128,400. Social Security and SSI beneficiaries are normally notified by mail in early December about their new benefit amount. This year, for the first time, most people who receive Social Security payments will be able to view their COLA notice online through their *my* Social Security account. People may create or access their *my* Social Security account online at www.socialsecurity.gov/myaccount. Information about Medicare changes for 2019, when announced, will be available at www.medicare.gov. For Social Security beneficiaries receiving Medicare, Social Security will not be able to compute their new benefit amount until after the Medicare premium amounts for 2019 are announced. Final 2019 benefit amounts will be communicated to beneficiaries in December through the mailed COLA notice and *my* Social Security Message Center. The Social Security Act provides for how the COLA is calculated. To read more, please visit www.socialsecurity.gov/cola.

NOTE TO CORRESPONDENTS: Attached is a [fact sheet](#) showing the effect of the various automatic adjustments.

Mark Hinkle, Acting Press Officer, press.office@ssa.gov, Thursday, October 11, 2018.

2. NASRA ISSUE BRIEF: EMPLOYEE CONTRIBUTIONS TO PUBLIC PENSION PLANS:

Unlike in the private sector, nearly all employees of state and local government are required to share in the cost of their retirement benefit. Employee contributions typically are set as a percentage of salary by statute or by the retirement board. Although

investment earnings and employer contributions account for a larger portion of total public pension fund revenues, by providing a consistent and predictable stream of revenue to public pension funds, contributions from employees fill a vital role in financing pension benefits. Reforms made in the wake of the 2008-09 market decline included higher employee contribution rates in many states. This issue brief examines employee contribution plan designs, policies and recent trends. For the vast majority of employees of state and local government, both participation in a public pension plan and contributing toward the cost of the pension are mandatory terms of employment. Requiring employees to contribute distributes some of the risk of the plan between employers and employees. The primary types of risk in a pension plan pertain to investment, longevity, and inflation. Employees who are required to contribute toward the cost of their pension assume a portion of one or more of these risks, depending on the design of the plan. The prevailing model for employees to contribute to their pension plan is for state and local governments to collect contributions as a deduction from employee pay. This amount usually is established as a percentage of an employee's salary and is collected each pay period. As shown in Appendix A, employee contribution rates to pension benefits typically are between four and eight percent of pay, and are outside these levels for some plans. In some cases, required employee contributions are subject to change depending on the condition of the plan, the fund's investment performance, or other factors. In some plans, the employee contribution is actually paid by the employer in lieu of a negotiated salary increase or other fiscal offset. Some 25 to 30 percent of employees of state and local government do not participate in Social Security. In most cases, the pension benefit—and required contribution—for those outside of Social Security is greater both than the typical benefit and the required contribution for those who do participate in Social Security. An appendix identifies whether or not most plan members participate in Social Security.

Trends in Employee Contributions

Many states in recent years made changes requiring employees to contribute more toward their retirement benefits: since 2009, more than 35 states increased required employee contribution rates. As a result of these changes, the median contribution rate paid by employees has increased. Figures show that the median contribution rate has risen, to 6.0 percent of pay, for employees who also participate in Social Security, and has remained steady at 8.0 percent for those who do not participate in Social Security.

New Contributions

Contribution requirements for certain employee groups in some states, such as **Missouri** and **Florida**, which previously did not require some employees to make pension contributions, were established in recent years for newly hired employees, existing workers, or both. Employees hired in **Utah** since July 1, 2011 must contribute toward the cost of their plan if that cost exceeds 10 percent of pay (12 percent for public safety workers). Because the cost of the plan remains below those thresholds, the Utah Retirement System remains non-contributory for most plan participants.

Variable Contributions

Some states, such as **Arizona, Iowa, Kansas, Nevada, and Pennsylvania** maintain an employee contribution rate that varies depending on the pension plan's actuarial condition. Because of the effect investment returns have on a pension plan's actuarial condition, the cost of a pension plan generally will rise following periods of sub-par investment returns and fall when investment returns exceed expectations. Changes approved in recent years in **Arizona** and **California** require some workers to pay at least one-half of the normal cost of the benefit, which can result in a variable contribution rate. Similarly, recent reforms in Michigan require newly hired school teachers to pay one-half of the full cost of the plan. And, as described previously, the **Utah** plan affecting new hires since July 2011 could become variable, depending on the plan's actuarial experience.

Increased Contributions for Current Plan Participants

Most employee contribution rate increases approved in recent years affected all workers-current and future. In some states, such as **Virginia** and **Wisconsin**, new and existing employees are now required to pay the contributions that previously were made by employers in lieu of a salary increase.

Hybrid Plans

A growing number of public employees now participate in hybrid retirement plans, which combine elements of defined benefit and defined contribution plans, and that transfer some risk from the employer to the employee. In one type of hybrid plan, known as a combination defined benefit-defined contribution plan, employees in most cases are responsible for contributing all or most of the cost of the defined contribution portion of the plan. Contribution requirements to the DB component of combination plans vary: some are

funded solely by employer contributions, while others require contributions from both employees and employers. In most of these cases, employees are also required to contribute toward the cost of the defined contribution portion of their hybrid plan benefit.^{iv}

Collective Bargaining

Employee contributions in some cases are set by collective bargaining, and can be changed when labor agreements are negotiated. For example, required employee contribution rates for employee groups in **California** and **Connecticut** increased in recent years as a result of labor agreements in those states.

Legal Landscape

The legality of increasing contributions for current plan participants varies. Some states prohibit an increase in contributions for existing plan participants. For example, a 2012 ruling in **Arizona** found that legislative efforts to increase contributions for existing workers violated a state constitutional protection against impairment of benefits. In other states, however, such as in **Minnesota** and **Mississippi**, higher employee contributions either did not produce a legal challenge, or withstood legal challenges (such as in **New Hampshire** and **New Mexico**).

Conclusion

Employee contributions are a key component of public pension funding policies. The vast majority of employees of state and local government are required to contribute to the cost of their pension benefit, and this number has grown in recent years as most states that previously administered non-contributory plans now require worker contributions. Many employees also are being required to contribute more toward the cost of their retirement benefit. In some cases, this requirement applies to both current and new workers; in other cases, only to new hires. A growing number of states are exposing employee contributions to risk – either by tying the rate directly to the plan’s investment return, or by requiring hybrid or 401k-type plans as a larger component of the employee’s retirement benefit. Nasra.org, October 2018.

3. \$505 MILLION IN REFUNDS SENT TO PAYDAY LOAN CUSTOMERS:

If you took out an online payday loan from a company affiliated with AMG Services, you may be getting a check in the mail from the FTC. The \$505 million the FTC is returning to

consumers makes this the largest refund program the agency has ever administered. The FTC sued AMG and Scott A. Tucker for deceptive payday lending. When consumers took out loans, AMG said they would charge a one-time finance fee. Instead, AMG made multiple illegal withdrawals from peoples' bank accounts and charged hidden fees. As a result, people paid far more for the loans than they had agreed to. In 2016 the FTC won a court case against AMG and Scott Tucker. Then in 2017, a jury convicted Tucker and his attorney of crimes related to the lending scheme. The FTC and Department of Justice are using money obtained in both court actions to give refunds to consumers.

Here are answers to questions about AMG refunds.

Who will get a refund? Checks are being sent to consumers who took out loans between January 2008 and January 2013 from these AMG-related companies: 500FastCash, Advantage Cash Services, Ameriloan, OneClickCash, Star Cash Processing, UnitedCashLoans and USFastCash.

How many people will get refunds? More than 1.1 million people will get refunds.

How does the FTC know whom to send the checks to? The FTC and a refund administrator have used AMG's business records to identify eligible consumers and calculate their refunds.

I am eligible for a refund. What do I need to do? If you borrowed from one of the lenders listed above between January 2008 and January 2013, you do not need to do anything. The checks are being mailed to eligible consumers automatically. There is no application process. If you borrowed from one of those lenders before January 2008, please call 1.866.730.8147.

How can I get more information?

Visit the [FTC's AMG refund page](#) or call 1.866.730.8147.

Three tips from the FTC:

1. If you get a check, deposit or cash it within 60 days.
2. The FTC never asks people to pay money or give information to cash refund

checks. If someone asks you to pay to get a refund from the FTC, it is a scam.

3. The FTC has advice if you are thinking about a [payday loan](#) or an [online payday loan](#).

Federal Trade Commission, Lesley Fair, Attorney, Division of Consumer & Business Education, September 27, 2018.

4. PENSIONS ARE SHELLING OUT BILLIONS IN FEES – AND IT IS NOT PAYING

OFF:

At a glance:

- According to the new report by the Pew Charitable Trusts, pension plans spend at least \$2 billion a year on investment fees.
- Over the past decade, pension plans have devoted more of their assets to alternative investments, such as hedge and private equity funds.
- The shift means that pensions are more vulnerable to stock market swings and are paying far more in fees than ever.
- The report recommends pension plans to change their reporting requirements.

Liz Farmer, *Governing*, September 26, 2018.

5. PEW GOT IT WRONG. PENSION FUNDS NEED ALTERNATIVE INVESTMENTS:

The Pew Charitable Trusts is out with a report on public pension funds featured the arresting subtitle: [“Substantial investment in complex and risky assets exposes funds to market volatility and high fees.”](#) There are two independent assertions here, both misleading. The first is that investment in risky assets exposes pension funds to market volatility. True enough, but the report documents that the amount allocated toward stocks has fallen from 61 percent in 2006 to 48 percent in 2016, the latest year for which data are available. So, the subtitle is true, but a fairer version might be “Declining investment in risky assets reduces funds’ exposure to market volatility.” The second assertion concerns complex assets and high fees. Public [pension funds](#) pay about \$12 billion in investment fees per year, and underperform passive investment strategies as a group by about the same \$12 billion. But the funds paying higher fees and making more use of alternative investments are not the ones paying the cost. With some exceptions, they outperform

passive after the higher fees. The worst net performances versus passive are seen in funds with moderate fees and low allocation to alternatives. Average stated investment fees have increased to 0.33 percent in 2016 from 0.26 percent of assets in 2006. But fees are not stated in standard ways, and may not represent the full cost of investments. I prefer to use an implied figure. I compute the return if a fund used the same allocation among stocks and bonds, but had used Vanguard index funds. The average pension fund would have earned an annualized 5.91 percent over the last 10 years with Vanguard, but the actual average return was 5.55 percent, suggesting the funds paid 0.37 percent in true economic costs over the sticker price to invest in a passive vehicle. Again the subtitle is literally true, but it suggests a link that does not exist between “complex” alternative assets and high fees and high risk. Alternatives as a group have significantly lower volatility and much lower market exposure than traditional portfolios limited to long-only investments in stocks and bonds. And there is a significant negative correlation (-0.36) between fund allocation to alternatives and implied investment fees paid -- more alternatives means lower fees. The alternative asset class contains many low-fee products, and there are plenty of managers who charge high fees to invest in stocks and bonds. The match between \$12 billion paid in fees and \$12 billion of underperformance relative to passive suggests public pension funds as a whole would be better off scrapping active management and alternative investments, and putting all their money into low-cost passive index funds. The amount paid in fees came straight out of net performance. There was no additional return associated with active management or alternatives. But what is true for public pension funds as a whole is not true for all funds individually. A graph stated fees paid versus fees implied by subtracting actual fund performance from its passive benchmark. The funds with negative “realized investment cost” earned more from outperforming a passive allocation strategy than they paid in fees. The funds with high realized investment cost either paid a lot in fees, or underperformed passive by a lot, or both. The data show no clear pattern between low or high fees and superior performance net of fees. The funds with the highest realized investment cost had the worst net performance and paid average to moderately above average fees. But the lowest stated fee funds, as a group, had slightly below average net performance. The best net performances were turned in by funds paying a range of fees from about half the average to three the times average. The two funds reporting the highest fees did not have terrible net performance. We get a clear picture if we graph realized investment cost versus allocation to alternatives. While there is quite a bit of variation around the trend, higher

allocation to alternatives is associated with better net performance relative to passive investment. The regression line suggests that going from zero to 50 percent alternatives improves net performance by one percent per year on average. No fund with less than 20 percent alternatives beat passive over the last 10 years. Since alternatives also likely reduce risk, it seems to be a win-win. The Pew report suggests that funds should cut market risk and fees paid, meaning put more money in passive bond index funds or U.S. Treasury securities. But a more granular look at the data suggests funds should be willing to embrace more broadly diversified portfolios and to pay fair fees, and that the damage is done by high-fee investments that underperform passive, not by any particular asset class. Aaron Brown, *Bloomberg*, October 3, 2018.

6. FDIC ANNOUNCES TRANSPARENCY AND ACCOUNTABILITY INITIATIVE:

Press Release

Federal Deposit Insurance Corporation (FDIC) Chairman Jelena McWilliams announced a new, agency-wide “Trust through Transparency” initiative in a speech at the 2018 Community Banking in the 21st Century Research and Policy Conference in St. Louis, Missouri. “Like any asset, trust must be earned and then preserved. In my view, the best way to maintain a trusting relationship is to be accessible, understandable, and responsive -- to provide your stakeholders with the information and means to hold you accountable.” Under the “Trust through Transparency” initiative, the FDIC launched a new section on its public website to provide new performance metrics that cross its business lines. The metrics will include data on the turnaround times for examinations and bank applications and timely response rates for the FDIC call center. The site also contains decisions related to appeals of material supervisory determinations and deposit insurance assessments, as well as information on the FDIC’s policies and procedures. The metrics will be updated regularly, and new materials will be added to the site as the agency creates more ways to shed light on the way it conducts business. In addition, the FDIC recently issued a request for information on how to make communication with insured depository institutions more effective, streamlined and clear. And, last month, the agency asked for comment on a proposal to retire more than half of the 664 risk management supervision-related Financial Institution Letters it issued between 1995 through 2017. These FILs are outdated or convey regulations or other information that is still in effect but

available elsewhere on the FDIC's website. A unique mailbox, transparency@fdic.gov, has been created to allow interested stakeholders to share ways the FDIC can improve transparency. "To promote real trust, we cannot simply make data available, publish performance measures, and consider the job complete. That is not transparency or accountability. Instead, we must strive to be accessible to financial institutions, consumers, and the general public; understandable to most audiences; and responsive to new ideas and demands," Chairman McWilliams said. Federal Deposit Insurance Corporation, PR-69-2018, October 3, 2018.

7. HERE ARE FACTS TO HELP TAXPAYERS UNDERSTAND THE DIFFERENT FILING STATUSES:

Taxpayers do not typically think about their filing status until they file their taxes. However, a taxpayer's status could change during the year, so it is always a good time for a taxpayer to learn about the different filing statuses and [which one they should use](#). It is important a taxpayer uses the right filing status because it can affect the amount of tax they owe for the year. It may even determine [if they must file a tax return at all](#). Taxpayers should keep in mind that their marital status on Dec. 31 is their status for the whole year. Sometimes more than one filing status may apply to taxpayers. When that happens, taxpayers should choose the one that allows them to pay the least amount of tax.

Here is a list of the five filing statuses and a description of who claims them:

- **Single.** Normally this status is for taxpayers who are not married, or who are divorced or legally separated under state law.
- **Married Filing Jointly.** If taxpayers are married, they can file a joint tax return. When a spouse passes away, the widowed spouse can usually file a joint return for that year.
- **Married Filing Separately.** A married couple can choose to file two separate tax returns. This may benefit them if it results in less tax owed than if they file a joint tax return. Taxpayers may want to prepare their taxes both ways before they choose. They can also use this status if each wants to be responsible only for their own tax.
- **Head of Household.** In most cases, this status applies to a taxpayer who is not married, but there are some special rules. For example, the taxpayer must have

paid more than half the cost of keeping up a home for themselves and a qualifying person. Taxpayers should check all the rules and make sure they qualify to use this status.

- **Qualifying Widow(er) with Dependent Child.** This status may apply to a taxpayer if their spouse died during one of the previous two years and they have a dependent child. Other conditions also apply.

Issue Number: Tax Tip 2018-153, October 2, 2018.

8. UNDERSTANDING SOCIAL SECURITY FOR THE PUBLIC SECTOR -- THE GOVERNMENT PENSION OFFSET:

Fair or not, those working in the public sector are treated differently than private-sector employees by the Social Security system, primarily through two rules that may reduce their Social Security benefits – the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). A previous article – [Understanding Social Security For The Public Sector: The Windfall Elimination Provision](#) – delved into the WEP, which resulted from the Social Security Amendments of 1983. Unlike the WEP, which affects your own worker benefit, the GPO rules impact spouses, ex-spouses and widows who are public-sector employees, have their own public-sector pension benefit and qualify for Social Security benefits. The GPO affects people who have a pension from employment that did not contribute to Social Security, including state or local government; school systems; colleges and universities; and the Civil Service Retirement System (CSRS). Before this provision, many government employees were eligible for their own government pension and full spousal, ex-spousal or survivor benefits. Initially Social Security benefits were intended for spouses who were financially dependent on the other spouse. Now, many spouses are not financially dependent on their spouse. The GPO prevents spouses, ex-spouses and survivors from receiving a higher benefit than they would have received if they were totally reliant on their spouses Social Security benefit to receive their benefit. The GPO affects you if you are a federal, state or local public-sector employee who relies on a state-run pension instead of Social Security. Today there are 15 states that do not cover their public-sector employees through Social Security, including Alaska, California, Colorado, Connecticut, Georgia, Illinois, Kentucky, Louisiana, Maine, Massachusetts, Missouri, Nevada, Ohio, Rhode Island and Texas. Tom R. Hager, *Forbes*, October 1, 2018.

9. IF EVEN PUTIN CANNOT FIX PENSIONS, WHO CAN?

Russian President Vladimir Putin is losing elections. That is not a sentence you read very often, but it is happening. Recently, the candidates of United Russia ceded ground in local, regional and gubernatorial polls across the country. I wish I could say that they were losing to democratic reformers, but democratic reformers are not allowed to contest elections in Russia. Genuine opposition parties are closed down, their leaders turned, jailed or killed. So, voters are turning to the tolerated alternatives, casting protest votes for parties that are every bit as authoritarian as Putin's but, in other ways, much uglier. The two chief beneficiaries are the Communist Party and the ultra-nationalist Liberal Democratic Party led by Vladimir Zhirinovskiy, who muses about rebuilding a Russian empire from Finland to Alaska. Despots can be genuinely popular and, until now, Putin's revanchism, which paradoxically mixes a delight in overseas aggression with a sense of wounded victimhood, has won him broad support. So, what changed? Two words: pension reform. Putin tried to sneak out a hike in the retirement age on the day that Russia won a five-nil victory over Saudi Arabia in the soccer world cup but, as protests mounted, he had to take to the airwaves and announce a partial climbdown: Women would now see their retirement age rise from 55 to 60 rather than 63 (men would still see theirs rise from 60 to 65). But three months on, the anger remains, and, as we all know, seniors vote. So, let me ask a depressing question. If Vladimir Putin, seen by Russians as a war leader, a man with (before all this) 80 percent approval ratings, an autocrat who is able to close down all but the most fawning media outlets -- if such a man is not able to tackle a pensions crisis, what hope have the leaders of multi-party democracies? Because, believe me, the demographic challenge is more severe in the West. For all our problems, we generally do not drink ourselves to death in our fifties in grim Siberian mining towns. Rising affluence and advances in medicine are happily lengthening our lives, but also stretching our length of our retirement obligations. When pensions were first introduced in the United States in the nineteenth century, they mostly started at 65, which became the official retirement age when the Social Security Act was passed in 1935. Life expectancy for the average American at the time was 58. Today, the retirement age is 66, but life expectancy is 79. Wonderful as this increase is, still greater miracles lie ahead of us. Over the past 20 years, medical science has started to treat old age, not as an inevitable condition characterized by a higher incidence of other diseases such as Alzheimer's and cancer, but as a disease in itself. Immense sums are being invested in

finding ways to slow cell decay -- which is what old age really is. My two-year-old son will probably live past 100, and it is not impossible that he could get closer to 200. Does anyone seriously think he will be retiring in his sixties? Almost every policymaker privately recognizes the magnitude of the challenge. State and federal employees are owed money in retirement that their younger compatriots simply will not be able to pay. Unfunded pension liabilities in the public sector amount to \$4.4 trillion, according to Moody's -- roughly the size of the German economy. Indeed, the gap may be even wider. The American Legislative Exchange Council reckons the pensions deficit to be above \$6 trillion. Either way, it has more than tripled over the past decade. In the states with the worst shortfalls, such as California, service providers have become, in effect, pension providers. The money set aside for firefighters, sanitation workers, and so on is going largely to those who were doing the job 20 years ago, which means there is less to spend on doing it now. America, in common with most Western countries, has its social security priorities all wrong. The largest sums go to people who are often comfortably well off and are, by the standards of a modern lifespan, in late middle age. In any case, the nature of work for most of us has changed beyond all recognition. Expecting me to type at a screen in my late sixties is very different from expecting my grandfather to work at the shipyards on the Clyde at that age. So, which elected representative will come out and say such things? Only, as far as I can see, the excellent Sen. Ben Sasse, R-Neb. And so the deficits continue to mount, and everyone looks awkwardly in the other direction. Then again, given the Putin example, can you blame them? Dan Hannan, Washington *Examiner*, October 1, 2018.

10. FDIC REQUESTS INFORMATION ON IMPROVING COMMUNICATION WITH BANKS AND OTHER STAKEHOLDERS:

Press Release

The Federal Deposit Insurance Corporation (FDIC) announced that it is seeking comments on how the agency can maximize efficiency and minimize burden when communicating information to insured depository institutions, consumers, and others, about laws, rules, and related matters. The request is part of Chairman Jelena McWilliams's initiative to enhance transparency and accountability at the agency by improving communication between the FDIC, the public and the banking industry.

“Providing information to depositors, consumers, bankers and other stakeholders is vital for them better to understand the agency’s policies, procedures and regulations. At times the amount of information disseminated can create burdensome challenges for insured depository institutions, especially community banks. To that end, we are seeking input on how the FDIC can improve the way it communicates,” said Chairman McWilliams. The Request for Information includes, for example, a request for ways to improve the FDIC’s process for disseminating information through Financial Institution Letters (FILs), which are about new regulations, policies, publications and other matters of interest to banks or savings associations. Other topics the FDIC is seeking comments on include:

- How effective are the FDIC’s current forms of communication? Are there other methods of communication the FDIC should consider?
- Is FDIC information readily available and easy to find? If not, how can the FDIC make it easier to receive and find information?
- How can the FDIC improve the FDIC.gov website?
- Which types of communication are best suited for informing insured depository institutions about new policies, laws, regulations as well as educational materials, news and other updates?

Comments on the Request for Information will be accepted for 60 days after publication in the Federal Register.

[Request for Info](#)

Federal Deposit Insurance Corporation, PR-67-2018, October 1, 2018.

11. NEW WHITE PAPER; ESG INVESTING FOR PUBLIC PENSIONS – DOES IT ADD FINANCIAL VALUE?:

The Institute for Pension Fund Integrity (IPFI) has released its latest [research](#). In the wake of the Trump Administration’s renewed guidance on environment, social and governance (ESG) investing in the April 2018 Department of Labor Field Bulletin, IPFI felt it was important to analyze the impact of ESG investing on public pensions. While the DOL guidance applies to private sector pensions, ESG investing is growing in popularity in both the private and public sectors, and it is important to understand the role it plays for public pensions. Public pensions across the country face more than \$6 trillion dollars in unfunded

liabilities. Therefore, while some investing strategies are seen as more popular than others, it is important for public pensions to focus on the returns gained to begin closing the gap. In the latest research by IPFI, the organization details how ESG investing differs in the public sector versus in the private sector. ESG has shown to add value to private investments, but in the public sector it ultimately comes down to the question of if ESG investments add financial value. Much of the research is still undecided on the impact of ESG investing on public pensions given the propensity for ESG investments to be made based on political, not financial, decisions. In the public sector, investment decisions should never be made based on the political impact of an investment. Christopher Burnham, President of IPFI, recently discussed this new research at a panel discussion hosted by the Pepperdine University School of Public Policy. He joined other pensions experts to discuss this and other challenges facing pensions. Other participants included:

- **Kathleen Kennedy Townsend**, Director of Retirement Security at the Economic Policy Institute
- **Dr. Wayne Winegarden**, Senior Fellow in Business and Economics at the Pacific Research Institute
- **Michael Belsky**, Executive Director of the Center for Municipal Financial at Harris School of Public Policy at University of Chicago
- **Hon. Joshua Gotbaum**, Guest Scholar, Economic Studies at Brookings Institute

At the panel, Mr. Burnham said, “ESG investing is valuable when it adds bottom-line performance to a pension. But it’s not the role of our public pension fiduciaries to make decisions based on what they think is good for society. Instead, they must make investment decisions based on one factor, and one factor only: does it add alpha?” This thinking supports IPFI’s other efforts given its goal to keep politics out of the management of public pension funds. This research and discussion comes as we reflect on the 10 years since the Great Recession. Considering that public pensions were almost 90% funded before the Recession and on average are now 68% funded, the impact of all investment decisions, whether ESG or otherwise, will be felt by retirees for decades to come. [Click here](#) to read IPFI’s new white paper: ESG Investing for Public Pensions - Does It Add Financial Value? Institute for Pension Fund Integrity, September 25, 2018.

12. PENNSYLVANIA COMMISSION REPORT FINDS STATE PENSION PLANS FAILED

TO REPORT BILLIONS IN FEES:

At an informal hearing held to examine how to improve Pennsylvania's two statewide pension systems, University of Oxford professor Ludovic Phalippou said the plans have spent more than \$12 billion on private equity fees over the course of their existences, much of which he said has gone unreported. The Public Pension Management and Asset Investment Review Commission held the informal hearing to examine the need for improvements in transparency around investment expenses and returns of the \$54.8 billion [Pennsylvania Public School Employees' Retirement System](#) and the \$29.8 billion [Pennsylvania State Employees' Retirement System](#), both in Harrisburg. Mr. Phalippou, who conducted an internal analysis of the fees and performance of the private equity funds held by the two plans, added that the two state plans have reported \$2.2 billion in fees over the past 10 years, but estimates that \$6 billion was spent with \$3.8 billion in what he described as "unreported fees." Mr. Phalippou was hired by the state treasurer's office to conduct the analysis. In response to Mr. Phalippou's testimony, PennSERS spokeswoman Pamela Hile said in an email that the pension system publishes "all manager investment fees and expenses by manager" each year, "including fees that are netted from distributions rather than billed directly." And although PennSERS does not track and report carried interest, Ms. Hile noted that the board passed a motion earlier this year "directing staff to request that the general partners/investment managers of private equity funds and real estate funds adopt and complete the Institutional Limited Partners Association fee disclosure template." Meanwhile, PennPSERS spokeswoman Evelyn Williams said the unreported fees the professor was referring to was carried interest, which "is not something that has been typically tracked/reported by public pension funds across the country," and added that "there is no industry consensus on reporting carried interest as a 'fee.'" That said, Ms. Williams noted that PennPSERS has "begun to compile carried interest data and the first report will be available after our October board meeting." Beyond that, PennPSERS "reports fees in our budget every year," said Ms. Williams. "You can find them on our [website](#)." The commission was established in 2017 to review the investment management practices of PennSERS and PennPSERS. Its goals are to recommend improvements to the two plans' stress testing and fee reporting transparency; analyze the plans' assets, investment strategies, investment performance, fees, costs and procedures against established benchmarks; and develop a plan to identify \$1.5 billion in cost savings over 30 years for each of the two systems. In August, PennPSERS passed a resolution to reduce fees by \$2.5 billion over the next 30 years. This was the second

hearing the commission held. The first was held in July, and the next is scheduled for Oct. 25. The commission plans to complete its review, report its findings and make its recommendations to Gov. Tom Wolf and the state's General Assembly sometime in November, but does not yet have a presentation date, said Heidi Havens, spokeswoman for state Treasurer Joe Torsella, who heads the commission. James Comtois, *Pensions & Investments*, September 24, 2018.

13. FDIC RELEASES RESULTS OF SUMMARY OF DEPOSITS SURVEY:

Press Release

The Federal Deposit Insurance Corporation (FDIC) today released the results of its annual survey of branch office deposits for all FDIC-insured institutions. The latest data are as of June 30, 2018. The FDIC's Summary of Deposits (SOD) provides deposit totals for each of the more than 88,000 domestic offices operated by more than 5,500 FDIC-insured commercial and savings banks, savings associations, and U.S. branches of foreign banks. The SOD includes historical data going back to 1994 that can be analyzed using online reports, tables, and downloads. SOD users can locate bank offices in a particular geographic area and create custom market share reports for state, county, and metropolitan statistical areas. Market share reports have been expanded to allow users to see market growth and market presence for specific institutions. The SOD is available at www5.fdic.gov/sod. To receive annual updates of the SOD, go to the subscription page at www.fdic.gov/about/subscriptions/index.html. Federal Deposit Insurance Corporation, PR-61-2018, September 14, 2018.

14. AGENCIES PROPOSE RULE REGARDING THE TREATMENT OF HIGH VOLATILITY COMMERCIAL REAL ESTATE:

Press Release

Board of Governors of the Federal Reserve System

SUMMARY: The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (collectively, the

agencies) are proposing to amend the regulatory capital rule to revise the definition of “high volatility commercial real estate (HVCRE) exposure” to conform to the statutory definition of “high volatility commercial real estate acquisition, development, or construction (HVCRE ADC) loan,” in accordance with section 214 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). Additionally, to facilitate the consistent application of the revised HVCRE exposure definition, the agencies propose to interpret certain terms in the revised HVCRE exposure definition generally consistent with their usage in other relevant regulations or the instructions to the Consolidated Reports of Condition and Income (Call Report), where applicable, and request comment on whether any other terms in the revised definition would also require interpretation. The proposal in its entirety can be accessed [here](#).

15. THE MARSHMALLOW TEST FOR RETIREMENT:

Walter Mischel, who used marshmallows to test children’s ability to delay gratification, died recently, but his lesson never grows old. For those who are not familiar with his famous [marshmallow test](#), a young girl or boy sits at a table with a single marshmallow on a plate. The tester tells the child that he or she can eat the marshmallow right away, but waiting to eat it until the tester comes back into the room will bring a big payoff: a second sweet, puffy morsel. Watching the children in this video squirm as they wrestle with their decisions brings to mind the adult equivalent. A desire for immediate self-gratification can come at the detriment of any number of personal financial decisions. Like the marshmallow test, consuming now means having less money in the bank later. The test also applies to deciding when to retire. Retiring becomes extremely tempting for baby boomers who want to escape from work after decades in the labor force. But those who wait patiently for a few more years will have a sweeter retirement: a much larger [Social Security](#) check and more 401(k) savings distributed over [fewer total years in retirement](#). Children, when faced with the marshmallow test, struggle mightily to exercise self-control. They pick up the marshmallow to examine it, play with it, nibble it, and move it out of reach – but impulse gets the better of them, and they pop it into their mouths. The lesson here is the same for children and adults: resist temptation and be rewarded. *Squared Away Blog*, Boston Center for Retirement Research, October 11, 2018.

16. REAL ASSETS RECOMMENDED FOR PUBLIC PENSION PLANS:

A new report from J.P. Morgan Asset Management, “Real Assets’ Role in Public Pension

Portfolios,” explores the use of [real estate and infrastructure](#) investments. The firm concludes that these asset classes can enhance returns and reduce volatility. J.P. Morgan says that public pension plans’ funded status has been well below pre-financial crisis averages. As of June 30, 2018, unfunded state pension liabilities were \$1.6 trillion, according to Moody’s Investors Service research. “The ratio of active participants to annuitants dropped from 2.4x in 2001 to 1.4x in 2016,” J.P. Morgan says. “The aging of the U.S. public pension system has caused persistent net cash outflows, raising the importance of income-producing assets.” The firm says that [core real assets](#) include well-leased properties in major developed markets, regulated utilities and other infrastructure sectors with predictable cash flows. In addition, transport assets—maritime vessels, aircraft, rail cars, etc.—that feature long-term contracts with high-credit quality counterparties can be considered to be core real assets. “Amid the current challenges facing pension plans, core real assets’ hybrid characteristics can play a key role in portfolios, providing the opportunity for a stable, volatility-reducing income stream along with the potential for equity-like upside from price appreciation,” J.P. Morgan says. “Whether acting as a replacement for volatile public equities or for low-yielding fixed income assets, core real assets may enhance the efficiency of public pension portfolios.” Further, the firm recommends that pension plans obtain the assets to fund core real assets by selling public equities and/or fixed income. “Determining the most appropriate real asset investment substitution and allocation will largely be defined in the context of investors’ funded status, current exposure to real assets and tolerance for the lower liquidity of core real assets relative to traditional financial assets,” J.P. Morgan says. “We think both increasing and diversifying the core real asset allocation can yield meaningful outcomes for plan sponsors. Adding core real assets to a pension portfolio can help plan managers—whether their objective is risk reduction, return enhancement or both.” The full report can be downloaded [here](#). Lee Barney, *Plansponsor*, October 8, 2018.

17. CORPORATE PENSION FUNDING RATIOS CONTINUE THEIR ASCENT IN SEPTEMBER – 3 REPORTS:

The estimated aggregate funding ratio of U.S. corporate pension plans rose slightly during September 2018, according to new reports from [Mercer](#), [Northern Trust Asset Management](#) and Wilshire Consulting. According to Wilshire, the aggregate estimated funding ratio for U.S. pension plans sponsored by S&P 500 companies increased 90 basis points to end August at 91.5%, which is up 7.2 percentage points over the trailing 12

months. The monthly change in funding resulted from a decrease in liability values of approximately 1.6 percentage points offset by a decrease in asset values of approximately 0.6 percentage points. The aggregate funding ratio is up 6.9 percentage points year-to-date. "September saw funded ratios increase due to the decline in liability value resulting from the increase in bond yields used to value corporate pension liabilities," said Ned McGuire, Wilshire Consulting managing director and member of its pension risk solutions group, in a news release. "September's 0.9-percentage-point increase in funding brings the aggregate funded ratio to a high point for the year for the third consecutive month and is the second highest since the end of November 2013." According to Mercer, the estimated aggregate funding ratio of defined benefit plans sponsored by S&P 1500 companies rose a full percentage point to 92% as of Sept. 30 from 91% a month earlier due to an increase in discount rates as well as an increase in equity markets. Discount rates increased by 9 basis points to 4.2% in the month. The estimated aggregate deficit of pension fund assets of S&P 1500 companies totaled \$171 billion as of Sept. 30, down \$18 billion from the end of August. Northern Trust Asset Management, meanwhile, estimated the average funding ratio of U.S. pension plans sponsored by S&P 500 companies rose to 90.7% as of Sept. 30 from 90.2% a month earlier, citing an 0.4% return by global equity markets and an increase in the average discount rate to 3.92% from 3.82% during September. Dan Kutliroff, Northern Trust's head of OCIO business strategy, said in a news release that the improved funding ratios provide sponsors a good opportunity to mitigate risks of future downward turns. "It remains a good opportunity for plan sponsors to consider preserving some of those gains by moving some of their assets from equity-like vehicles to fixed-income assets that behave more like the liabilities. This could help prepare plan sponsors to mitigate downward movements of funded ratio if and when a market correction occurs," Mr. Kutliroff said. Rob Kozlowski, *Pensions & Investments*, October 5, 2018.

18. DID YOU KNOW BENJAMIN FRANKLIN SAID THIS?:

"A right Heart exceeds all."

19. OXYMORONS:

Why do we put suits in garment bags and garments in a suitcase?

20. INSPIRATIONAL QUOTES:

Divide each difficulty into as many parts as is feasible and necessary to resolve it. - Rene Descartes

21. TODAY IN HISTORY:

On this day in 1931, American gangster Al Capone convicted of tax evasion.

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

Copyright, 1996-2018, all rights reserved.

Items in this Newsletter may be excerpts or summaries of original or secondary source material, and may have been reorganized for clarity and brevity. This Newsletter is general in nature and is not intended to provide specific legal or other advice.