



CYPEN & CYPEN

NEWSLETTER

for

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

1. SURVEY FINDS ADVISORS GOOD FOR RETIREMENT READINESS, CONFIDENCE, PLANNING:

A new study finds that Americans who work with financial advisors demonstrate higher levels of retirement readiness, disciplined planning, and financial confidence than those who don't. More than half (54%) of those with an advisor feel very financially secure. Only a fraction of people (21%) without an advisor said the same. Moreover, three quarters

(75%) of Americans with advisors consider themselves “disciplined” or “highly disciplined” financial planners - just 37% of those without an advisor embrace those characterizations. The importance of relationship also resonated in preferences around the delivery of advice. Six in 10 Americans said a human relationship combined with technology is ideal, while only 11% opted for a fully automated solution. Most (59%) of Americans with an advisor believe that, if they work past traditional retirement age, it will be by choice rather than from necessity (41%). Notably, the inverse is true for those without an advisor, with 6 in 10 (61%) expecting to remain employed past retirement age from necessity. Moreover, nearly 7 in 10 (67%) Americans who use a financial advisor believe they have clarity on how much to spend now and save for later, compared to less than half (44%) of those without an advisor, according to the [2018 Planning & Progress Study](#), an annual research project commissioned by Northwestern Mutual. Additionally, individuals without an advisor are more than twice as likely as people with an advisor (34% vs 13%) to say they are “not at all confident” they have the balance between spending and saving correct - which may offer insights as to why those without an advisor are more likely than those with an advisor (60% vs 37%) to point to debt reduction as a top priority. Survey respondents also cited several attributes that they said distinguished a remarkable advisor experience from just an acceptable one. “Someone I can fully trust to have my best interests at heart/not just out to sell product” emerged as the leading priority (57%). Other factors included:

- “Not feeling judged on size of assets/financial decisions” (36%)
- “Deep expertise across a wide range of financial solutions and strategies” (33%)

National Association of Plan Advisors (NAPA), December 27, 2018.

2. RETIREMENT ASSETS HIT \$29.2T: ICI REPORT:

Retirement assets grew nearly 3% from the prior quarter and stood at \$29.2 trillion as of Sept. 30, according to [the latest data](#) from the Investment Company Institute. ICI also says that U.S. retirement assets now account for one-third of all household financial assets. Assets in individual retirement accounts totaled \$9.5 trillion at the end of the third quarter, a jump of 3% from the second quarter. Defined contribution plan assets ended the period at \$8.1 trillion, up 3.3% from June 30. Government defined benefit plans (including federal, state and local government plans) were \$6.1 trillion in Q3, a 2.9% increase from the earlier quarter. Also, private-sector DB plans held \$3.2 trillion of assets,

with annuity reserves outside of retirement accounts accounting for another \$2.3 trillion. For employer-sponsored DC plans, assets totaled \$8.1 trillion as of Q3 -- of which \$5.6 trillion were held in 401(k) plans. Other private-sector DC plans accounted for \$550 billion, with \$1.0 trillion in 403(b)s, \$332 billion in 457s, and \$606 billion in the Federal Employees Retirement System's Thrift Savings Plan. Mutual funds represented \$3.7 trillion -- or slightly more than two-thirds -- of assets in 401(k) plans at the end of Q3. Equity funds, the most common type held in 401(k)s, accounted for \$2.3 trillion of that, with hybrid funds -- including target-date funds -- accounting for \$1.0 trillion. The Q3 total for IRAs amounted to \$9.5 trillion in assets, with close to half (\$4.5 trillion) held in mutual funds. Equity funds were the most common category of funds held in IRAs, at \$2.6 trillion; they were followed by hybrids, at \$949 billion. TDFs accounted for \$1.2 trillion as of the end of Q3, an increase of 4.0% from Q2. Retirement accounts held the bulk of TDF assets, with more than 85% held in DC plans (67% of the total) and IRAs (20%). Marlene Satter, *Think Advisor*, December 27, 2018.

3. PENNSYLVANIA PENSIONS COULD SAVE NEARLY \$10 BILLION OVER 30 YEARS:

A report commissioned by the state of Pennsylvania has identified potential cost savings of nearly \$10 billion over the next 30 years for the state's two largest retirement systems. The Public Pension Management and Asset Investment Review Commission (PPMAIRC) was created in 2017 by state law to conduct a comprehensive review of the investment management of the Public School Employees' Retirement System (PSERS) and State Employees' Retirement System (SERS). As part of its evaluation, the commission was tasked with finding \$3 billion over a 30-year period-- instead it found savings of close to \$10 billion. After a seven-month examination of Pennsylvania's two retirement systems, the report found an estimated potential annual savings of \$97.3 million to \$116.8 million. Expressed as actuarial savings over 30 years at the 7.25% assumed rate of return, the report said estimated savings would be between \$8.2 billion and \$9.8 billion. In compiling the report, the commission conducted three public hearings and received the testimony of academic experts, institutional investment professionals, state pension fund managers, and representatives from PSERS and SERS. The report found that both funds have underperformed relative to peers and have "consistently underperformed simple multi-asset portfolios" on a risk-adjusted basis. While costs have decreased by 50% over a 10-

year period at SERS and are now approaching peer group averages, both funds have higher-than-average expenses. The commission strongly recommended that the state maintain full payment of the annual actuarially determined contribution amount necessary to fund each pension plan “as doing so is fundamental and required to ensure the future financial viability of both retirement systems.” It said that without full annual funding, none of the commissions other recommendations would be enough to ensure the availability of retirement benefits for future generations of public servants. The other recommendations include:

- Establishing a consolidated central pension investment office that would be exclusively responsible for all investment functions on behalf of and as directed by each retirement system.
- Enacting legislation mandating annual stress testing of each retirement system in a manner that is aligned with the recommendations of the Society of Actuaries Blue Ribbon Panel, and publicly reporting the findings of the tests.
- Establishing policies at both system boards that favor and encourage open public reporting best practices, including, public reporting of an access to all investment costs and expenses at fund and manager level, full disclosure of all costs of private market investments, quarterly investment performance by asset class investment manager expense terms, and materials submitted to board trustees during open meetings.
- Enacting legislation mandating, as well as the repeal of existing laws that “frustrate, increased public reporting” of all investment expenses, total fund, and asset class investment.
- Moving to fully index all public market investments in both equities and fixed income at both retirement systems.

“The General Assembly has approved real and meaningful pension reform, but we need to do more,” State Rep. Michael Tobash, chair of PPM AIRC, said in a statement. “If these recommendations to the two public pensions systems are enacted, we will save taxpayers billions of dollars, reduce unnecessary risks and costs without compromising performance, and most importantly, keep our promise to existing retirees and system members.”

Michael Katz, *Chief Investment Officer*, December 27, 2018.

4. INDEX INVESTING: NOT AS PASSIVE AS YOU MIGHT THINK:

Index investing isn't really passive, according to a University of Toronto faculty member. "Rather than being passive in any meaningful sense, index investing simply represents a form of delegated management," wrote Adriana Robertson, assistant professor in the University of Toronto law faculty, in a paper, "Passive in Name Only: Delegated Management and 'Index' Investing," issued in November. The paper has been accepted for publication by the Yale Journal on Regulation, published by the Yale Law School, and is likely to be published in mid-2019, she said. "Instead of being truly passive, tracking an index almost always implies choosing a managed portfolio," Ms. Robertson wrote. "Not only are these indexes managed portfolios in the strictly financial sense, by their construction they imply a substantial amount of delegated decision-making authority." Is Ms. Robertson arguing that index investing is no different from active management? "The answer is obvious if you think about it," she said in an interview. "We have this idea in the back of our minds that indexes are passive because they're divorced from active management decision-making. But like active management, indexes are just the result of decisions by people." While the paper doesn't focus on institutional investing, Ms. Robertson said the decisions made by index providers to determine how the indexes are constructed, "should be a concern for all investors, including institutional investors." The paper reviewed more than 900 indexes, including 603 that are used as benchmarks for 3,208 mutual funds, she said. Ms. Robertson also argued that passive mutual funds and exchange-traded funds often follow indexes that were created for those funds. "The idea that an ETF might follow an index that it creates is counterintuitive and, to my knowledge, is not something that has been previously documented," Ms. Robertson wrote. However, the paper does not detail the impact of index creation for ETFs on expense ratios, although "digging deeper into this phenomenon is something that I intend to pursue in further work," Ms. Robertson said. The data on fees comes from the CRSP Survivor-Bias-Free US Mutual Fund Database. There are ETFs based on CRSP indexes. As a general matter, some indexes are created to be tracked by certain funds, Ms. Robertson said in the interview. "Someone will ask for a custom index to track. Other indexes, like the S&P 500, are used for lots and lots of things -- mutual funds and ETFs, but also options, futures, other derivatives." However, the paper's premise extends to broader indexes like the Standard & Poor's 500 stock index, Ms. Robertson added. One of the chief issues in Ms. Robertson's paper is that there's no disclosure on who ultimately is making the

decisions on index composition. "There's not a lot of regulation, there's no required disclosure of who the decision-makers are in index creation and composition, like there would be with decision-makers in a publicly traded company," Ms. Robertson said. "It looks like there are a lot of index funds out there that are following indexes that are not nearly as prominent as the S&P 500. These funds sometimes disclose that a third party created the index with the input of fund managers. But you can't see who actually is deciding what the index will be composed of." Ms. Robertson thinks that lack of information is "something I think people should be aware of. One way to think about it: If I buy an active mutual fund, the fund manager makes the decisions (on investments). But whoever is making the index is making the decisions on what's in them. The only difference between them is who is making the decision." However, Ms. Robertson doesn't think the solution is to require index providers to disclose how benchmarks are created. "I don't think we want regulators directly regulating indexes," she said. "There are so many indexes that are used for so many different things. I don't think we want to regulate that whole area on account of one particular use case -- mutual funds and ETFs. I think we just need to be aware that you need to know how indexes are composed and who is composing them. As I discuss in the paper, I think that the most appropriate means of regulation is via the regulation of the funds that use the indexes, not the indexes themselves." David Lafferty, senior vice president and chief market strategist at Natixis Investment Managers, Boston, and chairman of the research task force on the Investment Advisers Association's Active Managers Council, agreed with the paper's premise, saying that thinking of index funds as purely passive is a "mistake." "Investors tend to see the differences between active and passive as very black and white," Mr. Lafferty said. "Their intuition is that when you buy a passive fund, you're buying the market. However, this misses a key point that passive strategies are derived from indexes, and the creation of those indexes is a very active process. Investors are not simply buying the market, they are effectively buying how the index provider defines that particular market." Those decisions, Mr. Lafferty said, include "which securities to include, how they are removed, and how frequently the index is rebalanced. The active decision about which securities to include can be further broken down into decisions on size, liquidity, quality or myriad other factors. These active construction rules can have an enormous impact on the return profile of a passive strategy, especially those that are focused on more niche areas, like smart beta or factor-based indexes." However, Rolf Agather, Seattle-based managing director of

North American research at index provider FTSE Russell, said it's important to keep in mind the ultimate goal of an index. "You could categorize many of the decisions we make as active, and note that many of the indexes being created nowadays are more active in the sense that they differ from a broad cap-weighted benchmark," Mr. Agather said. "But it is important to note that the objective of these decisions is quite distinct from a traditional active strategy in that the goal of the index is to provide exposure to a particular market segment, whereas in a traditional active strategy the objective is to determine relative value of individual securities or market segments. The goal of the index is representation, not outperformance." Also, ETFs have "full transparency available to anyone through the methodologies in regards to their holdings," said Darek Wojnar, executive vice president and head of funds and managed accounts at [Northern Trust Asset Management](#), Chicago. "Some index providers have their own policies for disclosures, but ETFs disclose holdings on a daily basis," Mr. Wojnar said. "You could take a look at any ticker any day and find out the holdings. That's not always the case with active portfolios, which may provide that information weekly or quarterly." Rick Baert, *Pensions & Investments*, December 27, 2018.

5. THE AVERAGE SOCIAL SECURITY RETIREMENT BENEFIT IN 2019:

There are plenty of important social programs in this country, but none takes the cake like Social Security. Each month, close to 63 million people receives a Social Security benefit check, many of which are senior citizens. For these aged beneficiaries, more than 3 out of 5 rely on their payout for at least half of their monthly income. Ultimately, the guaranteed monthly benefit provided by Social Security to eligible beneficiaries is responsible for keeping [an estimated 15.3 million seniors out of poverty](#). As we enter the new year, a number of changes will be headed seniors' way. Most notably, they (as well as the long-term disabled and survivors) will be receiving a 2.8% cost-of-living adjustment, or COLA. Think of COLA as the "raise" that Social Security recipients receive each year that accounts for the inflation they've contended with.

What will the averaged aged beneficiary take home in the upcoming year?

Although a 2.8% COLA might sound rather ho-hum -- and historically it is -- it's the [largest increase in year-over-year benefits since 2012](#). But what does this mean for the average retired worker? Let's take a closer look. As of October 2018, the Social Security

Administration (SSA) notes that the average retired worker was bringing home \$1,419.34 a month, or about \$17,032.08 per year. Again, that may not sound like a lot, but the data doesn't lie: It's keeping plenty of elderly Americans out of poverty. Having begun 2018 with the average retired worker taking home \$1,406.91 in January 2018, this tells us that payout inflation (i.e., how much the average payout increases between the beginning of the year and the end of the year, based on SSA snapshot data) will likely be about 1.1% in 2018. Thus, the basis of the 2.8% COLA should be from an estimated \$1,422.39. So, what does this mean for the average retired worker? A 2.8% COLA from this estimated monthly benefit would yield an extra \$39.83 a month (\$1,462.22 a month as a whole), or close to \$480 extra a year.

An important reminder: You're probably not average

While \$480 in extra income probably sounds great considering the shelter (e.g., rent) and medical care inflation that senior citizens have dealt with in recent years, you should also understand that you, nor most people, are "average." According to the Social Security Administration, the program is designed to [replace about 40%](#) of the average retirees' working wages. However, this figure could be higher for low-income individuals and significantly lower for the well-to-do. The point being that the SSA doesn't view Social Security as a primary income source, and neither should you. Why, you ask? For starters the purchasing power of Social Security dollars has been [steadily declining for nearly two decades](#). An analysis from the Senior Citizens League found that what \$100 in Social Security dollars purchased in 2000 would only buy \$66 worth of the same goods and services as of January 2018. This purchasing power decline is the result of the program's inflationary tether (the Consumer Price Index for Urban Wage Earners and Clerical Workers) measuring the spending habits of urban and clerical workers rather than the seniors who make up the bulk of beneficiaries. Important expenses like medical care costs and housing tend to get underweighted, thereby leading to an insufficient COLA for aged beneficiaries. The other problem is that Social Security is itself in a bind. The latest annual report from the Social Security Board of Trustees forecasts that the program's \$2.89 trillion in asset reserves will be completely exhausted by 2034. That's because, beginning in 2018, the program will begin expending more than it collects in revenue each year. Ongoing demographic changes will worsen this net cash outflow in 2020, and with each subsequent year. Should the program's excess cash completely disappear, it could lead to

an [across-the-board benefit cut of up to 21%](#). If you're too reliant on Social Security, a 21% benefit cut, barring congressional intervention, could really hurt. And, as the icing on the cake, lawmakers on Capitol Hill [can't agree on anything](#) when it comes to fixing Social Security. Though both parties acknowledge the need to protect the program and close its estimated \$13.2 trillion deficit between 2034 and 2092, neither party will cede an inch to find common ground with their opposition and make a solution a reality. In sum, Social Security's COLA is golf clap-worthy in 2019, but there are bigger picture issues that current and future retirees need to be aware of.

Sean Williams, *The Motley Fool*, December 29, 2018.

6. FLORIDA'S MINIMUM WAGE IS INCREASING JAN. 1, BUT SOME WORKERS SAY IT'S NOT ENOUGH:

Florida's minimum wage rose from \$8.25 to \$8.46, in accordance with a 2004 [ballot amendment](#) indexing the wage to inflation increases. The minimum wage for tipped workers climbed, from \$5.23 to \$5.44 an hour. With the increase, Florida no longer has the second-lowest minimum wage among states whose minimum wages exceed the federal \$7.25 minimum. Still, it represents just a 2.5 percent increase. According to state Sen. Jose-Javier Rodriguez, the change will be insufficient to cover the rise in the cost of living many Floridians experienced in 2018, especially South Florida residents. [Data from the Bureau of Labor Statistics show](#) the average year-over-year increase in cost of living in the Miami-Fort Lauderdale-West Palm Beach metro area was well above 3 percent for most months of 2018. Florida's minimum wage inflation adjustment is tied to the bureau's consumer price index for the South region, which includes 16 states and Washington, D.C. "This is not a raise," Rodriguez said in October at an event at the Service Employees International Union's Miami headquarters that showcased the plight of Miami's hourly workers. "It doesn't look at the cost of healthcare, or changes in rents." In 2017, the most recent year for which data are available, [123,000 Florida workers](#) were earning at or below the minimum wage (the minimum wage [does not apply](#) to some hourly workers, like farm workers). In July, Miami-Dade [approved an ordinance](#) extending the county living wage of \$13.44, assuming health benefits are also provided, to any employee at Miami International Airport whose employer signs a new lease with the county. But [the ordinance](#) exempts employees of airlines. James McKnight, a wheelchair attendant at Miami International Airport who is represented by a union, said that as a result, he and hundreds

of other workers actually saw their pay decrease in 2018, from \$14 to \$9.50. Employees like McKnight used to work for EULEN America, a contractor; now, American Airlines has begun hiring its wheelchair attendants, and other workers, from Envoy Air, a subsidiary of American Airlines. Pay has been cut as a result, said the union, Communications Workers of America. “These are poverty wages,” said McKnight, 58. He said he and his coworkers get more than 1 million requests for wheelchairs a year. “We deserve \$15 an hour. It won’t make us rich, but it will ease the burden.” Envoy says it offers competitive pay, along with monthly employee bonuses when it meets its operational goals. It says its employees also participate in American Airlines profit sharing. A plan to gather signatures to put a \$15 minimum wage on Florida ballots in November [fell flat](#). The status of Miami’s Fight for \$15 movement chapter is not clear; its Miami representative could not immediately be reached. Another effort to put a \$15 minimum wage on 2020 ballots [launched by Orlando attorney John Morgan](#) has already raised nearly \$500,000, according to campaign documents. Miami Beach is still [waiting for a ruling from the State Supreme Court](#) on the city’s attempt to increase its minimum wage to \$13.31 by 2021. The ordinance is being challenged by the state, which believes it conflicts with the original 2004 minimum wage amendment. Oral arguments in the case have been scheduled for March 6, 2019. Business groups have opposed the increase, including the Florida Retail Federation, which [has said](#) the ordinance would “place an additional mandate on local businesses by requiring Miami Beach business owners to provide wages above what the state has previously established in law.” Rob Wile, Miami *Herald*, December 31, 2018.

7. IF ALASKA IS SERIOUS ABOUT KEEPING GOOD TEACHERS, IT SHOULD RETURN TO DEFINED-BENEFIT RETIREMENT:

I commend the University of Alaska for their ambitious goal to “grow our own” teachers and double the number education graduates hired by 2025. Homegrown, Alaskan teachers do tend to stay and have longer careers in our state. Recruiting more Alaska Natives who want to teach in their communities is also a necessity. Although I applaud this effort, without meaningful changes to the Tier III Teacher Retirement System, Alaska will fall very short of achieving this goal. Let me address the elephant in the room:

In 2005, when the legislature rushed through approval of TRS Tier III and Public Employee Retirement System Tier IV, they removed the defined benefit state pension, but

they did NOT put Social Security back in its place. This means that public school teachers hired after 2005 don't get Social Security; they only receive their own savings and 403B investments. By comparison, if you went to work at McDonald's, you would receive Social Security plus your own savings and investments, but if you are a teacher in Alaska, you don't. The math becomes compelling very quickly; go to college for six years to start a teaching job at \$55,000 per year in Alaska with no defined benefit retirement and no Social Security, or become a cardiovascular technologist/technician and receive the same starting salary plus Social Security with only an associate's (two-year) degree. Or join one of the trade unions, have your education paid through an apprenticeship, begin collecting a similar salary (or higher) when you become a journeyman, and receive your full Social Security benefit at retirement, plus union retirement benefits. Even though our rural villages desperately need and want local Alaska Native teachers to teach there, and there are scholarships to pay for almost all of the young Native students' bachelors and teaching degrees, I hear parents caution and even dissuade their high school graduates from going into teaching in Alaska because of the lower compensation and lack of retirement compared to other jobs. This is tragic. Let me address the problem from another angle: At the Alaska Career and Technical Education (CTE) Conference in October, I listened to Dept. of Labor Commissioner Heidi Drygas talk about the hiring boom on the horizon for skilled jobs in Alaska and that we need to get our students ready. I listened to Education Commissioner Michael Johnson talk about how desperately we need to recruit technical education teachers to train young people for these high-paying jobs. What they say is true. However, it is a tough sell to persuade a veteran electrician or heavy equipment mechanic who has 20 years' industry experience and is making \$80,000 to \$100,000 per year to go back to school to get a Type M teaching certificate, accept a \$55,000 beginning teacher's salary, sign the "windfall elimination provision" to receive only 40 percent of his or her Social Security earnings, and then, as a new Tier III TERS employee, no longer receive any Social Security. Unless a person is independently wealthy, the math just does not make sense for a qualified industry expert to become a public school CTE teacher. I agree 100 percent with the university's initiative to double the number of locally grown teachers produced and hired in Alaska. This needs to happen. But it won't happen until the Legislature rectifies the retirement structure of TRS Tier III. Even then, our best young teaching talent may still continue to be drawn into other fields that are better compensated. The public needs to be aware of the many significant financial factors

impacting young teachers' decisions and influencing our state's 20-30 percent teacher turnover rate. Outreach and mentoring will not be enough to reduce it. Anne Adasiak-Andrew, Anchorage Daily News, January 1, 2018.

8. SPOTLIGHT ON SIGNIFICANT REFORMS TO STATE RETIREMENT SYSTEMS:

Executive Summary

Although states have a history of making adjustments to their workforce retirement programs, changes to public pension plan design and financing have never been more numerous or significant than in the years following the Great Recession. The global stock market crash sharply reduced state and local pension fund asset values, from \$3.15 trillion at the end of 2007 to \$2.17 trillion in March 2009, and due to this loss, pension costs increased. These higher costs hit state and local governments right as the economic recession began to severely lower their revenues. These events played a major role in prompting changes to public pension plans and financing that were unprecedented in number, scope, and magnitude. Since 2009, nearly every state passed meaningful reform to one, or more, of its pension plans. Although the global market crash and recession affected all plans, differing plan designs, budgets, and legal frameworks across the country defied a single solution; instead, each state met its challenges with tailored changes specific to its unique circumstances. For example, some states faced legal limitations on how much modification could be made to their existing retirement plans. Other states did not require major law changes due to their financial condition or the presence of automatic adjustments in their plan designs.

Balanced Objectives

Public pension reforms typically adjusted retirement plan provisions while balancing multiple stakeholder objectives:

- For employees, competitive compensation that includes income security in retirement;
- For employers, a management tool to maximize the training and experience invested in their employees; and
- For taxpayers, public services performed in the most effective and cost-efficient manner.

These objectives can both conflict with and complement one another. Retirement plan reforms focused on one of these goals, to the exclusion of others, are likely to produce unintended negative outcomes. While public pension changes took different forms throughout the country, reforms generally kept those core features known to balance retirement security, workforce management, and economic efficiencies sought by stakeholders, namely:

- **Mandatory participation.** Most state and local governments require participation in the retirement program as a condition of employment.
- **Cost-sharing between employers and employees.** Public employees typically are required to contribute 5 to 10 percent of their wages on a tax deferred basis to their retirement benefit.
- **Pooled and professionally managed assets.** By providing professional management, greater portfolio diversity and economies of scale, pooled investments in public pension trusts can earn higher returns with lower fees.
- **Targeted income replacement.** Most public pension policies aim to replace a certain percentage of pre-retirement wages to better assure financial independence in retirement.
- **Lifetime benefit payouts.** The vast majority of state and local governments do not allow for lump sum distribution of benefits; rather, they require retirees to take most or all of their pensions in installments over their retired lifetimes. Most also make periodic cost-of-living adjustments to curb the effects of inflation.
- **Survivor and disability benefits.** Many state and local pensions integrate survivor and disability protections into their retirement programs, a particularly critical feature for positions involved in hazardous duty, or a public safety plan.
- **Supplemental savings.** Many governments sponsor a supplemental savings plan in addition to the general retirement plan to allow participants to defer an additional portion of their salary in anticipation of retirement needs, and some governments provide matching contributions and automatic enrollment/escalation features to encourage participation.

Reforms in most cases preserved these important features and modified some combination of required employee contributions, benefit levels, or eligibility for retirement. Many changes also shifted part of the risks associated with the retirement program from

the employer to the employee. This risk shift happened in mostly one of two primary ways: 1) the level of benefits or employee costs became dependent on the fiscal condition of the plan, including investment performance; or 2) more of an employee's benefit became dependent on individual savings plans, or both. Most of these changes apply to future employees, but many also impact existing employees and retirees. The following summary identifies the most common types of reforms, including changes that faced legal challenge, risk-sharing plan features that adjust employee benefit levels or costs without requiring legislation, and the public pension landscape following these reforms.

Employees Required to Pay More

Nearly all employees of state and local government are required to contribute toward the cost of their retirement; and in many states, budget challenges and rising pension costs made employee contribution increases a central part of pension reform. Employees in over 40 plans in 39 states were affected by increases to member contribution rates, some that are temporary, but more that are permanent or indefinite. Most increases impacted current members and new hires, although higher contribution rates in some states applied to new hires only. While a few state retirement plans prior to the recent reforms did not require employee pension contributions, nearly all now have this requirement. Some states, such as Missouri, added mandatory employee contributions for new hires only. Other states, such as Florida, enacted a required employee contribution for both new and current employees. States such as Virginia and Wisconsin passed laws requiring new and existing employees to pay the contributions that previously were made by employers in lieu of a salary increase. The new contribution requirement in Florida was challenged legally, and the Florida Supreme Court ultimately upheld it. Required contribution rates vary among plans, particularly between those that provide a benefit in addition to Social Security and those that provide a public pension benefit instead of Social Security. Employee contribution rates for non-Social Security plans remain higher than for plans whose members participate in Social Security. The median (mid-point) employee contribution rate in non-Social Security states is 8 percent of salary, although this number masks a wide range. The median employee contribution rate in plans that also provide Social Security coverage has risen from 5 to 6 percent during this period of pension reform. Higher required employee contributions was among the most common reforms passed by state legislatures since 2009.

Benefits Lowered

Pension benefits are intended to replace a certain amount of an employee's salary in retirement, typically through a formula that provides a percentage of salary for every year worked for the employer. For example, for a worker retiring with 25 years of service with a final average salary of \$50,000 in a pension plan that provides 1.5 percent of salary for each year worked, the annual pension benefit would be calculated as follows:

$$25 \times \$50,000 \times 1.5\% = \$18,750$$

As the calculation shows, three components are used to determine an employee's pension benefit: the number of years he or she worked for their employer; their average salary; and the retirement multiplier, which is the percent of income that will be replaced for every year worked. Benefit reductions passed since 2009 took a variety of forms, including:

1. An increase to the period used to calculate average salary (usually reducing the salary on which the benefit is based);
2. A reduced retirement multiplier (less percent of income per year worked);
3. An increase in the age and/or service that must be attained to qualify for a normal, or unreduced, retirement benefit; and
4. Reduced or eliminated cost-of-living adjustments (COLAs).

Many plans provide a COLA, which is an increase to benefits while in retirement, made annually or granted by discretion, to protect the benefits from inflation. COLAs vary in amount and often are linked to the actual rate of inflation. 9 A 2013 study by NASRA and the Center for State and Local Government Excellence found that benefit reforms could reduce the retirement benefit of new employees by between 1 and 20 percent, compared to pre-reform benefits. This finding did not include the future benefit impact through COLA reductions or eliminations, which could be considerable.

COLA Reductions Significantly Impact Benefits

Depending on how long a retiree lives, how much the COLA was reduced, and the actual rate of inflation, a COLA reduction can significantly reduce the value of a benefit over the

remaining life of a retiree. An annual COLA of two percent will increase the value of a pension benefit by nearly 50 percent after 20 years (and protect purchasing power from inflation). New COLA formulas for current active employees or new hires offer lower fixed-rate COLAs, which in many cases are linked to an external indicator such as CPI or the plan's funded status. Changes to COLA benefits for retired members were challenged in court in most states where they were passed. The cuts were upheld in most, but not all, cases. For example, the Oregon Supreme Court declared the 2013 reduction in the COLA for retirees in that state unconstitutional. Plans that reduced more than one element of the benefit formula (final average salary and retirement multiplier) saw the steepest cuts in benefits for new hires. Those that also changed COLAs further reduced the value of those benefits over time, sometimes significantly.

Employees Required to Work Longer

Pension plans for public employees require employees to work a certain period of time, known as the vesting period, to become eligible to receive any benefit from a pension plan. To begin drawing a benefit, the employee must also reach a second level of retirement eligibility, generally expressed as a certain age, a number of years of employment, or both. Nine states passed laws that increased the vesting period for new employees from 5 to 10 years. In two states – Missouri and North Carolina – the state later reversed its high vesting period, citing a lack of identifiable savings from the change and a conflict with the workforce management system. Other common reforms passed included increases to the age and service requirements that must be met to begin drawing a benefit. Thirty-three states increased retirement eligibility, affecting over 40 plans, and typically took the form of an increase in age, required years of employment, or a combination of both. These new requirements apply generally to new hires as part of the creation of a new benefit tier, although in a few cases the increased requirement applied to current employees. In establishing lower benefits for new hires, some states eliminated retirement at any age with a specified amount of service. Increases to retirement eligibility covered a wide range, from an additional one to five years of age needed and/or an additional two to five years of service required to become eligible to begin receiving a retirement benefit. Most increases to the retirement age were by two years, and most increases to required service were by five years.

Most States – But Not All – Retained Traditional Pension

Plan Nearly every state chose to retain its traditional pension plan and modify employer and employee contributions, restructure benefits, or both, as closing their traditional pension plan to future (and, in some case, existing) employees could increase -- rather than reduce -- costs. Providing only an individual account plan (i.e., 401k) often fails to meet important retirement security, human resource, or budget objectives. Some states, however, have looked at plan types that combine elements of traditional pensions and individual account plans. A combination hybrid plan combines a defined benefit plan, typically with a more modest level of benefit, with participation in an individual account plan. A cash balance plan features individual employee accounts with guaranteed investment returns on contributions. Most cash balance plans in the public sector require the benefit to be paid in the same way as a traditional pension, that is, monthly payments guaranteed over an employee's lifetime once the employee meets a required minimum age and/or years of employment. Some cash balance plans in the public sector, however, operate more like an individual account plan, where an employee may draw down on their accumulated account in retirement, which can be exhausted. Although hybrid and cash balance plans have been in place in public sector retirement systems for decades, this plan design has received increased attention in recent years. Since 2009, eight states – Arizona, Connecticut, Michigan, Pennsylvania, Rhode Island, Tennessee, Utah, and Virginia – created combination hybrid plans; and two states – Kansas and Kentucky – created cash balance plans for newly hired state or educational employees, or both. Rhode Island was the only state that passed a new plan type – a hybrid plan – requiring participation for some current plan participants. Two states – Arizona and Oklahoma – enacted legislation closing the traditional pension plan and placing newly hired workers into individual account plans. In Arizona, the change affected only future elected officials, and in Oklahoma, only state employees hired as of November 1, 2015, were affected. In most cases, changes to plan design were purely prospective, i.e., affecting newly hired workers only. In other cases, a new plan design was coupled with changes to the existing defined benefit plan, in an effort to address the costs.

Pension Reforms Faced Legal Challenges

Roughly half of the states faced lawsuits regarding their pension reforms. In many cases, what was upheld in one state was struck down in another. For example, employee

contribution increases were upheld in Florida, yet they were found illegal in Arizona. A reduction in retiree cost-of-living calculations was deemed constitutional in Colorado, yet was struck down in Oregon. Two clauses in the U.S. Constitution often cited as protecting pension benefits include: Article 1, Section 10 (clause 1), known as the Contracts Clause, states that "No State shall enter into any Treaty...impairing the Obligation of Contracts." The Fifth Amendment contains what is called the Takings Clause: "No person shall be ... deprived of life, liberty, or property, without due process of law..." Levels and types of legal protections for public pensions vary by state and are considered by some to be unclear or uncertain.

Self-Adjusting Features Can Alter Plans Considerably

Most public retirement plans are risk-sharing arrangements, meaning that the plan is designed to have employees share some of the risk of the benefit or its cost. Recent pension reforms clarified, strengthened, or established new risk-sharing mechanisms for benefit levels, required contributions, and delivery of benefits through different plan designs. Many state plans employ self-adjusting risk-sharing features that adjust benefit levels or required employee contribution rates without requiring legislation, and more states have added such features in recent years. Shared-risk features place some risk of changes to retirement plan costs or benefit levels on the employee and can include hybrid plans; employee contribution rates that can rise or fall depending on some external factor, such as the cost of the plan; or benefit levels that can change based on an external condition, such as the plan's funding level. For example, plans for some or all workers in Arizona, Iowa, Nevada, and Pennsylvania require employee contributions to fluctuate depending upon the plan's actuarial or financial condition. For public safety officers in Colorado, the board of the public retirement systems has the authority to increase the employee contribution rate; and in Idaho and some other states, the board can increase the total plan contribution rate, which is shared by employees and employers. In the vast majority of states, the employer contribution rate is adjusted automatically or by legislative action to meet an amount determined by the system's actuary. Other states automatically alter benefit levels depending on factors such as plan funding ratio, investment performance, inflation, or some combination of these. Retirees of the Wisconsin Retirement System (WRS), for example, receive a benefit that is automatically subject to annual adjustment depending on the level of reserve assets, which can rise or fall

depending on the performance of plan investments and other actuarial factors. WRS does not provide an annual COLA to retired members; rather, benefits may be adjusted if the fund experiences investment gains, and increases provided in prior years may be adjusted downward or eliminated entirely in years in which investments perform poorly (reductions may never fall below the base benefit). In 2014, WRS announced the first post-retirement benefit increase in five years after several years of favorable investment returns. Some Wisconsin retirees, particularly those who have been retired for longer periods, experienced five consecutive years of reduction in their benefit. In these and other instances, legislative changes were not required, but plan financing and benefit levels were nevertheless altered. In some cases, they were altered even more significantly than states that enacted pension reform legislation. Since 2009, 23 states have introduced or added one or more risk-sharing plan design features for broad employee groups. These include new hybrid plans, variable contribution rates, and benefits, including COLAs, that may change based on external factors, such as the fund's investment performance or the plan's funding condition. Other risk-distributing changes were made on an as-needed basis.

Public Pension Landscape Changed to Meet the Unique Needs of Each State

As the Center for Retirement Research at Boston College notes in its issue brief, "State and Local Pension Costs: Pre-Crisis, Post-Crisis, and Post-Reform," a state's appetite for pension reform was "largely in line with the size of the fiscal issues the state faced." This brief found that, generally, plans that were more poorly-funded enacted reforms that were more substantial than states that were better-funded. Each legislature passing pension reform approached the process given their unique set of economic and demographic circumstances. One outcome of nearly all reforms passed during this period, however, is that public employees are responsible for an increasing share of funding of their retirement benefits and in some cases, the accumulation of their own retirement assets. This NASRA report illustrates that retirement plans for public employees have been altered in many ways since 2009. The state-by-state listing in the appendix presents detailed descriptions of changes affecting various combinations of contributions, benefits, and eligibility for retirement plans that were affected by pension reform legislation. The descriptions are intended to portray the pension reforms as passed by the legislature in each state.

Florida Retirement System

Types of Pension Changes

- Increased Employee Contributions
- Reduced Pension
- Increased Age/Service Requirements
- Reduced Cost-of-Living Adjustment
- Changed Plan Design

Overview

The [Florida Retirement System](#) Florida Retirement System (FRS) administers pension and other benefits for most public employees in the state, including state employees; instructors and other employees in the K-20 education system; and employees of political subdivisions that have elected to participate. FRS assets are managed by the State Board of Administration, whose board members are the governor, state treasurer, and state comptroller. New employees since 2002 are given a choice between the traditional defined benefit plan and a defined contribution plan. For those hired before January 1, 2018, the defined benefit plan was the default plan option for those who do not make an active retirement plan election. For those hired on or after January 1, 2018, the default is the defined contribution plan. In 2011 the Florida legislature passed a series of changes affecting current active and newly hired state employees, teachers and public safety officers who participate in the FRS. One change is a requirement, effective July 1, 2011, that current active members contribute 3 percent of their salary towards their benefits. Prior to this change, employee contributions had not been required since 1975. Additionally, cost-of-living adjustments (COLAs) were frozen for all service after that date, meaning that when a member retires they will earn a COLA benefit only on the benefits earned up to July 1, 2011. Newly hired employees participate in a new tier with reduced benefits, increased age and service requirements needed to qualify for unreduced retirement benefits, and no COLA. Members of the new tier are estimated to have a beginning benefit that is approximately 3.5 percent less than an employee in the old tier.¹ Based on a study of the changes enacted that took effect July 1, 2011, the reforms reduced the plan's unfunded liability by \$1.1 billion. The blended cost, reflecting all employee groups and their benefit levels, of benefits earned each year by plan participants, was reduced by 7.13 percent of payroll and the contribution rate to pay down the unfunded liability was reduced by 0.32 percent. This produced a \$1.7 billion reduction

in the required employer cost in the first year. Legislation in 2017 changed the default plan for new state employees, teachers, and employees of participating political subdivisions hired on or after January 1, 2018. These members will have nine months in which to make an active choice between the defined benefit and defined contribution plan. If no election is made, they will default into the defined contribution plan. Keith Brainard & Alex Brown, National Association of State Retirement Administrators, December 2018.

9. WHAT FINANCIAL RISKS DO RETIREES FACE IN LATE LIFE?:

Introduction

Rising life expectancy means that many more Americans will reach very old ages. While longer lives are undeniably positive, they also mean that more people will face late-life financial risks for which they may be unprepared. These late-life risks include high out-of-pocket medical expenses; an increased possibility of financial mistakes due to declining cognitive abilities; and the specter of widowhood. The situation is generally expected to become more challenging, because future retirees will be more reliant on often-modest 401(k)/IRA lump sums rather than the automatic lifelong payment stream of a traditional pension plan. At the same time, a rising Full Retirement Age means monthly Social Security checks will provide less relative to pre-retirement income at any given claiming age. In short, future retirees will likely have less reliable income as they reach advanced ages. This brief reviews research by the U.S. Social Security Administration's Retirement Research Consortium and others on the nature and extent of late-life financial risks. The brief is organized as follows. The first section explains how demographic and economic changes are leading to a larger population susceptible to these risks. The second section explores the nature of the three risks outlined above. The final section concludes that out-of-pocket medical expenses, financial mistakes, and widowhood tend to severely impact the finances of only a minority of older Americans today, but that those threats may be more widespread in the future.

Conclusion

The United States is facing a challenge – the number of individual's ages 75+ is growing, and this group will be more reliant on 401(k) wealth and less on traditional pensions and Social Security. This brief focused on three risks to their financial health: 1) out-of-pocket medical costs; 2) cognitive decline; and 3) widowhood. The takeaway from the research

literature seems to be that, so far, these risks adversely affect some retirees severely, but this outcome may not be that common. However, in the future, a growing number may experience such an outcome. The silver lining is that these challenges can be seen in advance, so researchers, policymakers, and individuals themselves have time to develop and implement solutions. Matthew S. Rutledge and Geoffrey T. Sanzenbacher, Center for Retirement Research at Boston University, January 2019, Number 19-1.

10. DID YOU KNOW BENJAMIN FRANKLIN SAID THIS?:

By failing to prepare, you are preparing to fail.

11. INSPIRATIONAL QUOTES:

It's not the years in your life that count. It's the life in your years. – Abraham Lincoln

12. TODAY IN HISTORY:

On this day in 1984, Apple Computer Inc. unveils its revolutionary Macintosh personal computer.

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

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