



CYPEN & CYPEN

NEWSLETTER

for

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

1. SOCIAL SECURITY BENEFITS INCREASE IN 2019:

Each year we announce the annual cost-of-living adjustment (COLA). Usually, there is an increase in the Social Security and Supplemental Security Income (SSI) benefit amount people receive each month, starting the following January. Law requires that federal benefit rates increase when the cost of living rises, as measured by the Department of Labor's Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W).

The CPI-W rises when prices increase for the things the average consumer buys. This means that when prices for goods and services we purchase become more expensive, on average, the COLA increases benefits and helps beneficiaries keep up with the changing cost of living. More than 67 million Americans will see a 2.8 percent increase in their Social Security and SSI benefits in 2019. This month marks other changes based on the increase in the national average wage index. For example, the maximum amount of earnings subject to Social Security payroll tax will increase to \$132,900 in 2019. The retirement earnings test exempt amount [will also increase](#). Want to know your new benefit amount? In December 2018, we posted Social Security COLA notices online for retirement, survivors, and disability beneficiaries who have a my Social Security account. You can view and save these COLA notices securely via the Message Center inside my Social Security. Next year, be the first to know! Sign up for or log in to your personal my Social Security account. Choose email or text under "Message Center Preferences" to receive courtesy notifications so you won't miss your electronic COLA notice! This year, even if you accessed your COLA notice online, you still received your COLA notice by mail. In the future, you will be able to choose whether you receive your notice online instead of on paper. Online notices will not be available to representative payees, individuals with foreign mailing addresses, or those who pay higher Medicare premiums due to their income. We plan to expand the availability of COLA notices to additional online customers in the future. Check our website for more information about the [2019 COLA](#). You can also read our publication [Cost-of-Living Adjustment](#). Jim Borland, Acting Deputy Commissioner for Communications, Social Security Administration, January 3, 2019.

2. CORPORATE - \$28 TRILLION AND PERSONAL LIABILITY; ERISA ROARS BACK:

In the 45 years since the Employee Retirement Income Security Act of 1974 (ERISA) went into effect, U.S. retirement plan assets have soared to a staggering \$28 trillion. With a pool of assets that large, there's been an explosion of ERISA class actions in recent years. Indeed, the 10 highest ERISA class action settlements in 2017 with respect to employer-sponsored retirement plans totaled nearly \$1 billion. With courts increasingly siding with plaintiffs in ERISA retirement plan cases, there appears to be little hope that the trajectory of these class actions will reverse. At the same time, plaintiffs are exploring new avenues of attack. Historically, ERISA litigation has focused on the duties,

responsibilities, and actions of the retirement plan's fiduciaries--typically, the board and company executives. Under ERISA, those fiduciaries are charged with one main objective: to act solely in the best interests of plan participants. Class action suits against companies have alleged that fiduciaries have violated that rule by, for example, making imprudent decisions regarding investment choices, or failing to manage plan documentation or monitor people hired to carry out plan duties. In recent years, ERISA fiduciary litigation has increasingly focused on excessive plan fees and expenses. "There has been an increase in class action litigation by plan participants who are basically saying that their employer's 401(k) plan charged them too much--and the plan fiduciaries should have shopped around and found better deals," says David McFarlane, a partner in Crowell & Moring's Corporate, Health Care, Tax, and Labor & Employment groups in Los Angeles. "And those can be huge lawsuits. In some, the employer has ended up being on the hook for reimbursing retirement accounts for millions--sometimes hundreds of millions--of dollars." The focus on fees is not the only change taking place in ERISA 401(k) litigation. Under the law, fiduciaries are held personally responsible for their decisions--or even those of their co-fiduciaries--and plaintiffs are beginning to take advantage of that. "Recently, we've started to see lawsuits naming individuals as defendants, not just companies," McFarlane says. "It used to be that only the plan sponsor would be sued by a class of 401(k) participants. Now we're seeing executives and board and committee members being named individually--meaning that their house, their car, and their savings are at risk for something they may not have known was happening under their watch." The fiduciaries involved with a retirement plan usually include members of the board of directors, the CEO, the CFO, the vice president of human resources, and "any employee in the company who has discretion to make a decision with respect to the administration of the retirement plan," he says. Often, businesses will carry directors' and officers' (D&O) liability ERISA fiduciary insurance as a hedge against personal liability exposure. However, those policies might not be sufficient when it comes to ERISA fiduciary litigation. "D&O policies may not cover ERISA-related liability at all, or there may be special provisions, such as requiring executives to get annual fiduciary training," McFarlane says. "Even if there is coverage, it might be woefully inadequate compared to the size of the plan or the risks involved." Insurance companies are beginning to take notice of the size of ERISA class actions and are tightening restrictions on D&O ERISA coverage and adjusting premiums. Retirement-focused litigation has resulted in a significant body of

jurisprudence and regulatory interpretation, which has set the stage for the next wave of ERISA litigation: employer-sponsored health plans. The United States spends approximately \$3 trillion a year on health care, making the oversight of company health plans an attractive target for plaintiffs. Such plans have been covered by ERISA since it was passed, but over the course of four decades, there has been comparatively little litigation on that front. However, that has been changing with rapidly rising health care costs and the implementation of the Affordable Care Act, which required more companies to provide medical insurance. These factors prompted employers to collect cost sharing premiums from employees or become self-insured, thus creating a new target for ERISA fiduciary breach actions. “The plaintiffs’ bar is now arguing that those employee premiums and other costs, such as pharmacy rebates, are ERISA plan assets, and that every decision that a plan sponsor makes with respect to use of those plan assets is a fiduciary decision,” says McFarlane. “The idea is that if you are not keeping your eye on details like co-pays, types of coverage, pharmacy benefits, and lower premiums, you may have committed a fiduciary breach and may be sued under well-developed theories from retirement plan litigation.” As a result, he adds, “fiduciaries overseeing health plans have to be exceptionally careful to follow the same golden rule that they have to follow with retirement plans. Make sure that what you’re doing is solely in the best interest of participants.” Personal liability is especially relevant in this area, because there are often more fiduciaries involved in the administration of health plans than retirement plans. Looking ahead, fiduciaries’ decisions about monitoring costs and who they appoint and hire to administer health plans will be important drivers of ERISA litigation--and often, companies are not fully aware of this growing threat. At the same time, the already intense focus on 401(k)s and pensions can be expected to continue. Altogether, these trends have the potential to put more companies and a wider group of company fiduciaries at risk of becoming class action targets. In addition, says McFarlane, a growing interest in areas such as cybersecurity breaches of plan accounts and the recovery of plan assets can be expected to open up new areas of fiduciary exposure. In all of these ERISA issues, the key is prevention. McFarlane notes that the best protection for employers and D&O insurers is to demonstrate that the plan sponsor has undertaken regular and in-depth compliance reviews of retirement and health plans. That means providing proof that the plan sponsor has reviewed plan documentation for compliance with applicable law, undertaken review of governance and delegation of authority structures, provided external

fiduciary training, and demonstrated regular monitoring and benchmarking. In general, companies need to make sure that their fiduciaries perform due diligence and follow clear decision-making processes. “One of the best ways to get early dismissal of a lawsuit is to show that the plan fiduciaries did their job--not a job held to the standard of perfection, but one that demonstrates reasonable and prudent compliance with their fiduciary duties,” he says. With the increasing emphasis on personal liability, companies also need to make sure that people in those roles are qualified for the job--a factor that may be getting more scrutiny. In September 2018, after losing a class action lawsuit against New York University over the handling of retirement funds, the plaintiffs turned around and sued for the removal of two of the fiduciaries involved--an action based on the court’s ruling that noted that the two lacked the capabilities needed to effectively oversee the plan. “It’s more important than ever to have people in those fiduciary roles who understand their responsibilities and the issues involved,” says McFarlane. “You don’t want someone who is just going to rubber-stamp the decisions of others.” Taking action to recover damages awarded in class action suits has become an increasingly common practice for companies--but they need to pay attention to recovering retirement and health plan assets, as well. “Plan sponsors have a duty to consider and participate in antitrust and other class action recovery efforts in order to maximize returns and assets for plan investments on behalf of plan participants,” says Crowell & Moring’s David McFarlane. “Companies haven’t really focused much on their retirement and health plans when thinking about recovery. But they need to.” Pursuing recovery may well be in the best interest of plan participants. As a result, he says, “failure to do so may expose the officers, directors, and others to personal liability under ERISA.” For example, a class action suit might involve faulty equipment purchased by a corporation. At the same time, however, the corporation’s retirement plan might have invested in that equipment manufacturer and thus have a potential claim against it. The corporation needs to keep the two identities separate--that is, the pension committee needs to pursue its own claim, independent of the company. And if there is a settlement that covers both parties’ claims, the committee needs to sign off on its portion--the company cannot do so for that portion. If it does, it could be at risk of violating its fiduciary duties to plan recipients. At times, a corporation may decide not to pursue recovery of damages against another company for business reasons--the company in question might be a partner or customer, for example. However, says McFarlane, “the pension plan cannot consider those factors as governing--it can only

consider what is in the best interest of the plan participants. So except in extraordinary situations, it has a compelling duty to go after those plan assets.” Otherwise, he adds, “plaintiffs could bring a class action lawsuit against the company and the fiduciaries individually, arguing they have breached their duty by not attempting to bring those assets back into the pension plan.” Crowell & Moring’s, January 9, 2019.

3. LIFE INSURANCE MARKETING AND RESEARCH ASSOCIATION FINDS 4 IN 10 SMALL BUSINESSES CURRENTLY OFFER RETIREMENT BENEFITS:

Life Insurance Marketing and Research Association (LIMRA) research shows Americans’ top financial concern is affording a comfortable retirement and access to a workplace savings plan is the most effective way to get people to start to save for retirement. However when it comes to small businesses (2-99 employees) only 42 percent offer retirement benefits - either along with insurance benefits or alone. The good news is LIMRA research finds 40 percent of small business employers (2-99 employees) feel retirement benefits are more important now than three years ago with 57 percent say it is equally as important. LIMRA research also shows there is a trend in the number of employees within the small business and the importance of retirement benefits. While only 37 percent of companies with less than 10 employees say they are more important now than three years ago, that number goes up to 64 percent for companies with 50-99 employees. The larger the small business, the more likely they were to say retirement benefits are more important today than three years ago. Separate LIMRA Secure Retirement Institute (LIMRA SRI) research points out that retirement plan access is the top reason American workers start saving for retirement. Nearly 4 in 10 of all workers said they began to save for retirement because their employer offered a retirement savings plan. While 36 percent of small businesses don’t currently offer retirement benefits to their employees, 4 percent plan to in the next two years, and 19 percent of them report they might. Another way small business employees might be able to utilize workplace retirement savings plans is through multiple-employer plans (MEPs) -- retirement plans that are sponsored by multiple employers. Federal proposals in 2018 are intended to broaden the number of small employers who can participate in MEPs (by making them available to groups on unrelated employers), thereby expanding the number of employees who can access retirement savings plans at their workplace. This should help increase the number of employees who can access retirement savings plans through their

employment. Life Insurance Marketing and Research Association (LIMRA), January 10, 2019.

4. GOVERNMENT SHUTDOWN BRINGS UNCERTAINTY FOR WORKERS HOPING TO RETIRE DURING IMPASSE:

Roughly 800,000 federal employees didn't know when their next paychecks would arrive, because of the partial government shutdown. But there was also uncertainty for federal employees of currently closed agencies who planned to retire. According to [guidance](#) on the Office of Personnel Management's website, if an employee requested a retirement date that conflicted with a shutdown, the agency should "make the retirement effective as of the date requested," adding that the retirement request can be informal, but any additional required paperwork, such as the formal retirement application form, may be completed when the agency reopens. But in a webinar Tuesday, Jessica Klement, staff vice president for advocacy at the National Active and Retired Federal Employees Association in Washington, said there are still some questions. "If you submitted your retirement application before the government shut down and your retirement date is during the shutdown then yes, you are in fact retired," she said. "But you're also probably wondering if your paperwork's been processed and unfortunately I don't have a good answer for you there because there is no one answer. If your payroll department is furloughed, processing of your retirement package may be delayed." A representative from OPM could not immediately be reached for comment. In an email, Kim Weaver, spokeswoman for the \$553.8 billion Thrift Savings Plan, explained that once an employee submits retirement paperwork, the employee's agency then transmits it to OPM, which then sends a separation code to the TSP to process any withdrawal requests the employee makes. "At the agencies affected by the shutdown, most HR employees are furloughed so there is no one to send the paperwork to OPM," Ms. Weaver said. (OPM is) working through retirement applications that they already had received pre-furlough, so that information is being sent to us as it is finalized." Brian Croce, *Pensions & Investments*, January 10, 2019.

5. U.S. CORPORATE PENSION FUNDING RISES TO NEAR 90% IN 2018:

The funded status of the 100 largest U.S. corporate pension plans rose 2.3 percentage points to 89.9% at the end of December from the year-earlier period, according to the

Milliman 100 Pension Funding index. Assets dropped 6% for the year to \$1.462 trillion as of Dec. 31, due to poor market performance. However, liabilities also fell to \$1.6 trillion, thanks to a discount rate increase of 66 basis points. In aggregate, these plans experienced a \$56 billion improvement in funded status for the year. "The fourth quarter's asset losses and stagnant discount rates derailed what had started out as an optimistic year for corporate pensions," said Zorast Wadia, co-author of the Milliman 100 PFI. "Looking ahead to 2019, with those asset losses and in spite of the discount rate improvement, we're likely to see pension expense increase in the coming year." Under an optimistic forecast with interest rates reaching 4.8% by the end of 2019 and 5.4% by the end of 2020 and asset gains reaching 10.8% annual returns, Milliman predicts that the funded ratio would climb to 104% by the end of 2019 and 120% by the end of 2020. However, under a pessimistic forecast, with a discount rate of 3.59% by the end of 2019 and 2.99% by the end of 2020, and 2.8% annual returns, Milliman predicts that the funded ratio would decline to 83% by the end of 2019 and 77% by the end of 2020. James Comtois, *Pensions & Investments*, January 11, 2019.

6. THE PENSION FUND PROBLEM JUST GOT MUCH WORSE:

The 14 percent drop in the S&P 500 Index last quarter has big implications for state and local pension funds, which probably saw the value of their assets fall by about 7 percent. Investors with the benefit of a long-term horizon have the ability to ignore [market dips](#), and pension funds are among the longest-term investors, but their problems are not long-term and further short-term declines could precipitate a crisis. A table shows pension fund assets and liabilities as compiled by [Pew Charitable Trusts](#). There is a large and growing gap, but that's not the primary problem. Although the value of those assets is known with reasonable accuracy, the liability figure is based on assumptions about the future. The actuarial and political assumptions are uncertain, but it is the investment assumptions - plans assume an average discount rate of 7 percent - that are the most problematic. Average returns for pension-fund-like portfolios only generated returns of 7 percent or greater for 50-year periods twice since 1871, for investors who started soon after World War I or World War II. Starting at a random time generated an average return of 5.30 percent, ranging from a low of 3.16 percent to a high of 7.99 percent. The problem is worse for two reasons. First, cumulative returns are lower than averages. A return of 7 percent grows \$100 to \$114.49 in two years. A 50 percent return in the first year and a

loss of 36 percent in the second results in an average of 7 percent, but causes that \$100 to decline to \$96. Second, an extended period of bad returns cannot be made up even with astronomical returns later. Suppose a fund has 50 years of level monthly payments and assets to support them assuming a 7 percent return. If the fund earns zero over the first 15 years, one might think the fund needs to average 10 percent over the final 35 years to meet its obligations. In fact, the fund is broke in less than 15 years, and it doesn't matter what returns are afterwards. Due to those two effects, if a fund started on the best possible date, June 1949 - earning an average 7.99 percent - it went broke in 1986. The fund's final 13 years of obligations went unpaid even though its average return was almost 1 percent above the normal assumption. Even if pension funds were fully funded according to assumptions, there is no chance existing assets are enough to pay already-contracted liabilities. But worrying about the next five decades is pointless, because there's also no chance the current system will survive long enough to discover what the next 50-year average returns will be. Once total assets start to decline, as they did in 2016 (the last year for which we have aggregated national data), you can get [a death spiral](#) with an ever-shrinking base of assets failing to produce the needed income, leading to asset sales and further declines in income. We're nowhere near the tipping point on an aggregate national level, but aggregate national flows will not trigger a crisis. New Jersey added \$27 billion in liabilities in 2016, and lost \$6 billion of assets because contributions and investment earnings [couldn't even cover benefit payments](#), much less build the fund to pay for additional benefits earned. A chart shows the assets and liabilities for New Jersey state and local pension funds. A simple extrapolation of the lines suggests a crisis around 2023, when pension fund assets are wiped out. That's an extrapolation, not a prediction. [Market returns](#) and [political actions](#) could move the date a few years in either direction. Moreover, action will be forced before assets go to zero. We don't know when or how or what will happen, but it won't depend on average investment returns over the next few decades. This brings us back to the recent decline in the stock market. This commentary uses 2016 pension fund data. Most pension funds use a June 30 fiscal year, so fourth-quarter calendar 2018 results will be reported in late 2019 or 2020. The two major aggregations of the thousands of fund reports will be published in mid-2021. If stocks continue down to the point that a major state passes the tipping point to crisis, the crisis will be well advanced before we see it in aggregate pension financial reports. The state and local pension crisis has passed from a long-term actuarial crisis to a medium-

term cash flow crisis. Forget about liability projections and aggregated national numbers. Look at the least responsible big states and focus on asset values, inflows and outflows. That's where disaster will force a new regime.

- These are estimates based on stock, bond and inflation returns reported by Yale University Professor Robert Shiller.
- Earning 10 percent for 70 percent of the period, 35 out of 50 years, averages 7 percent per year.
- Getting the 1950s, 1980s and 1990s bull markets and ending at the height of the dot-com bubble.
- Increased funding is still a good idea. The earlier the problem is addressed, the less painful the adjustments. But full funding according to existing accounting will not prevent an eventual crisis.
- The general picture is similar, although not as extreme, for states such as Illinois, California, Connecticut, Kentucky and Colorado.
- We've already seen financial disasters in Detroit, Puerto Rico and numerous smaller places, but in these cases pension underfunding was part of larger fiscal and governance problems. These events will certainly continue, but will not force a major nationwide policy realignment.
- The Pew Charitable Trusts cited above and the U.S. Department of Census Annual Survey of Public Pensions.

This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners. Aaron Brown, Bloomberg, January 13, 2019.

7. THE 10 CITIES WITH THE LARGEST HIGH-NET-WORTH POPULATIONS:

The global population of high-net-worth individuals increased last year by just under 2 percent, according to a [recent report by Wealth-X](#), and it represents a population that's spread across the world, albeit unevenly. HNW individuals, categorized as having a net worth between \$1 million and \$30 million, still prefer living in the U.S. over other countries. There are more than 8.6 million HNW individuals living in America, which is home to six of the top-10 HNW cities around the globe. While these cities still have the largest number of HNW residents, seven of the 10 are losing their wealthiest citizens. Among the top 40 cities with the fastest-growing HNW populations, 32 were in China, and all of them were in

Asia. China's largest city for UHNW and HNW is Shanghai, with 123,000 HNW individuals. Samuel Steinberger, Wealth Management, January 16, 2019.

8. WHY RETIREES SHOULDN'T FEAR A BEAR MARKET:

What many retirees are most afraid of: Running out of money before they die. An [Allianz Life](#) survey found that far more retirees are afraid of outliving their money than they are of dying--61% to 39%. This ever-present background fear is especially rearing its ugly head right now, given the bear market that to many came out of nowhere. In just three months' time, the S&P 500 [SPX, +0.63%](#) dropped more than 20% (on an intraday basis), thereby satisfying the semiofficial definition of a bear market. Retirement planning projections made at the end of the third quarter, right as the stock market was registering its all-time highs, now need to be revised. The reason not to give up hope is that the stock market typically recovers from bear markets in a far shorter period of time than most doom and gloomers think. Consider what I found when measuring how long it took, after each of the 36 bear markets since 1900 on the bear market calendar maintained by Ned Davis Research, for equities to make it back to the bull market highs that preceded those bear markets. My measurements took into account dividends and inflation, which is important because analyses based on nominal price action alone exaggerate bear market recovery times. Believe it or not, the average recovery time was "just" 3.2 years. Assuming the bear market that began at the end of September ends today, and assuming the recovery time lives up to historical averages, the stock market will once again trade in new-high territory in December 2021. Furthermore, it wouldn't take even this long if it weren't for some outliers in the calculation of this historical average. The median recovery time--that length of time such that half of the bear market recoveries were shorter and half longer--is 1.9 years. Assuming the recovery time equals this median, the stock market will once again be in new-high territory in September 2020. To be sure, there's no guarantee that the future will be like the past, of course. And even if it is, the recovery time from the current bear market could end up being longer than the median or the average. But even then we need to exercise care not to exaggerate the recovery time. Take the financial crisis, which led to the worst bear market since the Great Depression. By my calculations, the stock market on a dividend-adjusted inflation-adjusted basis took 5.4 years to overcome that bear market and surpass its pre-bear-market high from October 2007--March 2013, in other words. And while 5.4 years is a long time, it doesn't have to be devastating. For

example, that recovery time is less than the life expectancy of any male currently aged 86 or younger, according to the actuarial tables at the [Social Security Administration](#). Any female aged 90 or less has a life expectancy greater than this recovery time from the financial crisis. Most retirees that old should have long since reduced their equity exposure, of course. What is far more likely to make the current bear market devastating is not the recovery time but throwing in the towel at the bottom, going to cash, and not getting back in until the stock market has produced a significant rally. If you do that, you are guaranteed to suffer 100% of the losses and benefit from only a fraction of the recovery. The losses we've endured since late September are painful. But we've already incurred them. Going to cash only adds insult to injury--unless you happen to be the rare market timer who succeeds in getting back into equities at a lower level than where the market stood when you get out. Mark Hulbert, Market Watch, January 29, 2019.

9. MODERNIZING SOCIAL SECURITY: MINIMUM BENEFITS:

Social Security offers a minimum benefit to retired workers with very low career earnings. However, the current level of this benefit is not enough, by itself, to prevent poverty even for full-career workers, and it is withering away due to a design flaw. As a result, many policy experts support redesigning the minimum benefit. Virtually all experts agree that full-career workers should get a benefit that keeps them out of poverty. Some also support broadening eligibility for the minimum benefit by reducing the earnings level needed to build up qualifying credits. Others would take the opposite tack, narrowing eligibility by raising the number of years needed for a full or partial benefit. This brief is the final one in a series on modernizing Social Security to account for changing social, economic, and demographic circumstances. The discussion proceeds as follows. The first section provides the basics on Social Security benefits for low earners. The second section introduces the key design elements of the current minimum benefit. The third section reviews several reform proposals. The fourth section assesses the reforms based on three criteria: targeting efficiency, administrative feasibility and cost offsets. The final section concludes that an enhanced minimum benefit has wide appeal and could substantially reduce poverty risk, with the breadth of the impact dependent on how eligibility is determined. A broad consensus exists for reforming Social Security's minimum benefit. Reformers have suggested various ways to ensure that a new minimum benefit would keep at least full-time, full-career workers above the traditional poverty level. The main

difference in the proposals revolves around who should be eligible for a minimum benefit. The narrower reforms tilt more toward workers with longer careers and relatively higher earnings while broader reforms would make it easier for those with shorter careers and lower earnings to qualify. In any case, reforming the minimum benefit would clearly succeed in reducing poverty risk for some older Americans. Andrew D. Eschtruth and Alicia H. Munnell, Number 19-2, Center For Retirement Research at Boston College, January 31, 2019.

10. DID YOU KNOW BENJAMIN FRANKLIN SAID THIS?:

It is easier to prevent bad habits than to break them.

11. POSERS:

Why is the letter W, in English, called double U? Shouldn't it be called double V?

12. INSPIRATIONAL QUOTES:

If the wind will not serve, take to the oars. – Latin Proverb

13. TODAY IN HISTORY:

On this day in 1997, US & Russia announce summit set for Helsinki, March 20-21.

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

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