



CYPEN & CYPEN NEWSLETTER for August 22, 2019

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

1. FIDELITY HIGHLIGHTS BENEFITS OF DEFAULT CASH OPTIONS FOR RETAIL ACCOUNTS:

Since 2015, Fidelity has been defaulting client cash in retail brokerage accounts to their U.S. government money market fund. Now, they took the opportunity to compare that default cash yield to competitors'. Fidelity today highlighted its long-standing policy of automatically placing excess client cash in retail brokerage and retirement accounts into its government money market fund, comparing the yields earned there to the default sweep accounts at other brokerages. Brokerage firms typically place the cash portion of a client's portfolio into a so-called "sweep" account, usually with an affiliated bank, that earns the client very little, with yields hovering around .04% to .13% at the major brokerages for small amounts of cash. Since the third quarter of 2015, Fidelity has been automatically defaulting client cash in retail brokerage accounts to its Fidelity Government

Money Market Fund (SPAXX), which recently posted a 7-day yield (the average yield of the fund's portfolio over the past seven days) of 1.91%, as of August 5. Last May, the firm started doing the same with cash in retail retirement accounts. The fund invests in a portfolio of U.S. government securities, including agency fixed and floating rate securities and government repurchase agreements. "Fidelity changed the automatic default selection for brokerage cash to SPAXX in Q3 2015, and retirement cash to SPAXX in May 2019. What we're doing today is shining a light on an industry practice that investors should be aware of to avoid potentially leaving money on the table," said a Fidelity spokesperson. While Fidelity has no account minimums for the option, clients do pay the .42% expense ratio for the fund, cheaper than the average .61% fee for U.S. government money market funds, according to Crane Data, which tracks money market funds. The fund has \$129 billion in net assets. For advisors who custody at Fidelity, there is no change to the cash sweep default. "Our custody clients have multiple cash options available for their customers, including money market funds and our FDIC-insured Bank Deposit Sweep Program. Advisors have told us that they want the ability to choose the cash option that is right for their clients," said Fidelity Clearing and Custody Solutions' spokesperson Rachel Shaffer. "You've seen brutal competition in the brokerage marketplace," said Crane Data's Peter Crane. "Almost all of the others are sweeping to FDIC accounts with miserable yields." Most brokerages have eliminated the option for directing brokerage cash into a money market account at sign up. Many brokerages have eliminated the option for sweeping cash into money market accounts. Firms profit from the sweep accounts by using the funds for higher yielding purposes while paying brokerage clients a pittance on the deposit. E-Trade, for example, defaults to a cash sweep account that yields .07%. In its most recent quarterly earnings report, E-Trade has some \$61 billion in cash and deposits in retail accounts. TD Ameritrade's default sweep yields anywhere from .04% to .43%. Schwab pays .18% in their cash sweep account for amounts under \$1 million. To be sure, money market funds don't have the same protections that bank sweep accounts do. They aren't insured by the Federal Deposit Insurance Corporation, and returns are not guaranteed, though U.S. government securities are considered a safe investment option akin to cash. "Some firms have removed the option of a higher yielding money market fund for their cash sweep, thereby forcing investors to take additional steps to get a better rate for their cash," said Kathleen Murphy, president of Fidelity Investments' personal investing business in a statement. "It is unfortunate that millions of investors lose out on having money in these accounts earn more for them based on current industry practices." David Armstrong, WealthManagement.com, August 07, 2019.

2. NEW YORK IMPLEMENTS NEW STANDARD FOR ANNUITIES SALES:

In New York state, new regulations demanding broker/dealers selling annuities be held to a "best interest" standard goes into effect today. [The amendment to Regulation 187](#) takes

New York state's oversight of annuities sales a step further than the state's current "suitability" standard. The amendments were passed last July, with a scheduled phase-in date for August 1. The law requires that financial services providers consider the interests of the consumer above everything else when making the annuity recommendation, mandating that any advice be "based on an evaluation of the relevant suitability information of the consumer and reflects the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use under the circumstances then prevailing." The new rule will also put new disclosure and training requirements on b/ds and insurers that sell annuities, as well as forbid sellers of annuities from calling themselves advisors unless they are licensed as such. "A producer shall not use a title or designation of financial planner, financial advisor or similar title unless the producer is properly licensed or certified and actually provides securities or other non-insurance financial services," according to the rule. "Although a producer may state or imply that a sales recommendation is a component of a financial plan, a producer shall not state or imply to the consumer that a recommendation to enter into a sales transaction is comprehensive financial planning, comprehensive financial advice, investment management or related services unless the producer has a specific certification or professional designation in that area." The new regulations are coming into effect after the Securities and Exchange Commission passed their Regulation Best Interest standard last month, while the changes were originally made to address regulatory gaps on the federal level after the U.S. Department of Labor's Fiduciary Rule [was eliminated in March 2018](#), according to Financial Services Superintendent Maria T. Vullo. "As the federal government continues to roll back essential financial services regulations, New York once again is leading the way so that consumers who purchase life insurance and annuity products are assured that their financial services providers are acting in their best interest when providing advice," she said last year. "Given the key role insurance products play in providing financial security to middle class New Yorkers, it is essential that a provider adhere to a high standard of care and only recommend insurance and annuity products that are in the consumer's best interests and not be influenced by a producer's financial incentives." According to Richard Roth, a founder and partner at The Roth Law Firm, the legislation could potentially be a harbinger of the future path the state Legislature may take. "I think New York state is essentially getting closer to calling for a fiduciary (standard)," Roth said about the new regulations. "The legislature has determined that this is required, because certain brokers aren't doing what's best. They want to add another layer of culpability." Several states, including [Nevada](#) and [New Jersey](#), have proposed some form of legislative or regulatory fiduciary rules to pertain to all investment advisors and b/ds in their state. [Massachusetts announced its own rule](#) shortly after the SEC released Reg BI, arguing that the federal regulatory shortfalls made it necessary for the state to act. Though the New York amendments pertain only to those b/ds selling annuity

products, Roth believed the new regulations might inspire other states. “New York has always been a leader when protecting investors, so I wouldn’t be surprised if some states follow suit,” he said. “It’s only a matter of time before it happens. If a broker is handling my money, they’d better do it in good faith. I think we’re just heading in that direction.” The regulations [will take effect](#) for providers selling life insurance policies on February 1, 2020. Patrick Donachie, WealthManagement.com, August 01, 2019.

3. LOCAL PENSION COSTS GREW IN CALIFORNIA AT NEARLY SIX TIMES NATIONAL RATE, NEW DATA SHOW:

Median pension costs for local governments grew nearly six times as much in California as the rest of the country over a decade, according to new data compiled by a UC Berkeley professor. Median pension costs went up \$7,022 per employee in a selection of cities and counties in California from 2007 to 2016, compared to a national median increase of \$1,216, Sarah Anzia, an associate professor of public policy, said Wednesday in Sacramento. The rising pension costs have consumed an increasing share of local government revenues, absorbing an additional 2 percent of general revenues over the 10-year stretch in California compared to a national median of 0.7 percent, [according to Anzia's data](#). “Local government is being affected by high pension costs,” Anzia said. “It’s not in the future, it’s now.” Anzia analyzed spending of 442 local governments around the country, including some from every state and 26 cities and counties in California. Her results are in working paper form, and have yet to be peer-reviewed for publication in an academic journal. But she suggests her results could fill a gap in public policy debates, since most researchers have focused on pension plans and their performance rather than on local government impacts. “This dataset is unlike any that existed before, and it is uniquely suited to the task of assessing the on-the-ground experiences of American cities and counties,” she wrote in the paper. She found correlations between pension cost increases and union activity and collective bargaining, which is more common in California than many other states. From 2007 to 2016, per-pension costs for local governments with less than 50 percent union membership increased by a median \$740, while those with more than 50 percent increased by a median \$2,950. CalPERS administers pensions for many local governments in California along with state workers’ pensions. Like most pensions around the country, CalPERS doesn’t have enough money to cover all of its current and future obligations to public workers. The \$377 billion fund, the nation’s largest, has about 70 percent of the assets it would need to pay all those obligations, leaving it with what is known as an unfunded liability. Many of those obligations won’t come due for decades, and that distance has spurred disagreement among academics and policymakers over how urgent the underfunding is. “California’s pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently,” California’s Little Hoover Commission [reported in](#)

[2011](#), after the Great Recession had deeply affected CalPERS' funded status. In 2014, another group of researchers concluded unfunded pension liabilities and financial problems in Detroit and Illinois didn't signal a broader crisis. "The question is whether cities across the country are about to topple like dominoes--and whether pensions are the problem. The answer, the authors write, appears to be 'no' on both fronts," according to a study abstract. Anzia said she doesn't fall into either camp, but hopes her data can make the pension debate more tangible for a broader audience. "It stands to affect everyone who relies on local government service provision, including police and fire protection, refuse collection, public parks, libraries, and county court systems," she wrote of increasing pension costs. "Rising pension expenditures are already changing the landscape of local government, and the findings here suggest that the future of local government may look very different than the past." Part of the uncertainty about the future lies in pension funds' expected rates of return on their investments. When the funds don't make as much money in a given year as expected, and the shortfall isn't made up in extra payments from employers, employees or another source, the unfunded liability grows. CalPERS in 2016 started [reducing its target return-on-investment rates](#) from 7.5 percent. The fund returned about 6.7 percent this year, falling short of a new 7 percent target. The changes mean local governments pay more to make the fund more financially sound in the long run. Last year, the League of California Cities [surveyed 170 local governments](#) about their pension contributions, finding that most cities expected their contributions to increase by at least 50 percent by 2024, to an average of 15.8 percent of general fund budgets. Anzia on Wednesday suggested CalPERS should reduce the target rate even more, a change she said would give local governments a more realistic picture of the costs of their pensions. Her study was funded by the Laura and John Arnold Foundation, the Berkeley Institute for the Future of Young Americans and the Institute for Research on Labor and Employment. Wes Venteicher, *The Modesto Bee (Ca.)*, August 01, 2019.

4. ARE YOU READY? PROPOSED REGULATIONS ON HARDSHIP DISTRIBUTIONS:

In late 2018, the Internal Revenue Service ("IRS") issued proposed regulations ("Proposed Regulations") regarding hardship distributions from 401(k) and 403(b) plans. Beginning on January 1, 2020, plans must operationally comply with some of the key provisions of these Proposed Regulations. In addition, plans must be amended by December 31, 2019 to reflect any optional changes implemented in 2019.

WHAT DO I NEED TO KNOW?

Existing Treasury regulations dictate when 401(k) plans and 403(b) plans may permit hardship distributions. A hardship distribution must be:

1. made on account of an "immediate and heavy" financial need; and
2. necessary to satisfy the financial need.

In general, whether a participant's financial need is "immediate and heavy" and "necessary" is determined based on all facts and circumstances. However, existing regulations offer a safe harbor for determining whether the two requirements have been satisfied. Under the existing safe harbor, six types of expenses are automatically deemed to be requested on account of an "immediate and heavy" financial need:

1. medical care described in Internal Revenue Code ("Code") § 213(d) for the employee, the employee's spouse or the employee's dependents (regardless of whether the expenses exceed 7.5% of adjusted gross income);
2. costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);
3. payment of tuition, related educational fees, and room and board expenses for up to the next 12 months of postsecondary education for the employee, the employee's spouse, or the employee's children or dependents;
4. payments necessary to prevent the eviction of the employee from the employee's principal residence or to prevent foreclosure on the mortgage on that residence;
5. payments for burial or funeral expenses for the employee's deceased parent, spouse, children or dependents; or
6. expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under Code § 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income).

Recap of the Proposed Regulations

The Proposed Regulations expand the list of expenses for which hardship distributions are deemed to be made on account of an "immediate and heavy" financial need to include the following:

1. **Addition of Expenses for Primary Beneficiaries.** Medical, educational and burial/funeral expenses now include those incurred for the participant's "primary beneficiary under the plan," meaning an individual who is named as a beneficiary under the plan and has an unconditional right to all or a portion of the employee's plan account balance upon the employee's death.
2. **Expenses Incurred as a Result of Certain Disasters.** Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by the Federal Emergency Management Agency ("FEMA"), if the

employee's principal place of residence or employment at the time of the disaster was located within an area designated by FEMA for individual assistance.

3. **Casualty Loss.** Damage to a principal residence that would qualify for a casualty deduction under Code § 165 is no longer required to be in a federally declared disaster area, which eliminates the limitation imposed by the Tax Cuts and Jobs Act.

Existing regulations prohibit a participant from making employee contributions after receiving a hardship distribution. The Proposed Regulations eliminate this requirement for distributions made on or after January 1, 2020. They also prohibit plans from suspending participant contributions after the participant receives a hardship distribution. This prohibition is mandatory only for distributions made on or after January 1, 2020. Existing regulations require a participant to take all available plan loans prior to receiving a hardship distribution. The Proposed Regulations eliminate this requirement. The Proposed Regulations permit, but do not require, 401(k) plans--but not 403(b) plans--to allow participants to take hardship distributions from participant elective deferrals, qualified non-elective contributions, qualified matching contributions and/or the earnings on those contributions. Qualified non-elective contributions and qualified matching contributions held in a custodial account continue to be ineligible for hardship distributions. Under existing regulations, if a plan does not rely on the safe harbor rules, the plan administrator must determine whether the claimed need is "immediate and heavy" and "necessary" based on individual facts and circumstances. The Proposed Regulations eliminate this facts and circumstances test and replace it with a three-part test ("Three-Part Test"). The Three-Part Test requires:

1. **Not in Excess of Need.** The hardship distribution may not exceed the amount of a participant's financial need (including any amounts necessary to pay taxes or penalties reasonably anticipated to result from the distribution);
2. **Obtained Other Available Distributions.** The participant must have obtained other available distributions under the employer's plans before taking the hardship distribution; and
3. **Insufficient Liquid Assets.** The participant must represent that he or she has insufficient cash or other liquid assets to satisfy the financial need.

Plan administrators have been allowed to apply the Three-Part Test since January 1, 2019, but the requirement to obtain a participant's representation of insufficient liquid assets becomes mandatory for hardship distributions made on or after January 1, 2020.

WHAT DO I NEED TO DO?

1. **Prepare for operational compliance.** Plan administrators should prepare to comply operationally with the Proposed Regulations mandatory changes.
2. **Amend plans for implemented changes.** Plan sponsors that have elected to implement optional changes in 2019 should amend their plans by December 31, 2019 to reflect these changes.

Ice Miller Legal Counsel, 2019

5. STATEMENT AT THE SEC STAFF ROUNDTABLE ON SHORT-TERM/LONG-TERM MANAGEMENT OF PUBLIC COMPANIES, OUR PERIODIC REPORTING SYSTEM AND REGULATORY REQUIREMENTS:

Bill [Hinman] thanks a lot. I'm going to highlight three items to try and kick us off here. First, a thank you to Bill, Coy, Shelley and the other staff from the Division of Corporation Finance for the work you did in hosting today's roundtable and on a day to day basis. This event demonstrates the commitment of the Division to important issues that have a direct impact on our Main Street Investors and your commitment to fair and transparent markets. I also want to thank our panelists. As I look across here if I was investing my money for the long term, this would not be a bad investment committee. You are giving up your time to share your vast experience with us. You represent a variety of viewpoints from long term investors to issuers, from preparers of SEC reports to consumers of that information. So thank you very much for giving us your time. Second, I think we need to always keep in mind who we are doing this for. At least from my perspective, it's our long term Main Street investors who invest directly in our markets, but also more the case and I think increasingly the case through funds and pension plans. Having this perspective is--their perspective--in mind is I think key to understanding why long term perspective on investing is important. Put simply, they are investing for the long term and it's their money that's in our markets as they save for retirement or other life events. We think about them every day at the Commission and they're not investing for next week, they're not investing for next year. Predominantly they're investing for something 10, 20, 30 years away and they expect their money to be managed that way. But we do recognize that their perspective is not exclusively long term. The investment decisions that they make or their advisors make rely substantially on timely and quality disclosure. And it is this timely and quality disclosure that fosters market liquidity that every investor needs at some point in their investment life. But I believe that there is not a tradeoff between long-termism and liquidity. Said another way, I don't believe that to have effective liquidity you need a short term focus. Too often in Washington we think there's a tradeoff of one thing for another. We should be looking for rules of the road that foster both liquidity and a long term perspective. Third, today's agenda and the comments we've received so far on our

request for comment demonstrate that if we are going to make strides to foster a longer term perspective in American companies, we need to consider these issues from two points of view. One is to look at the macro forces that drive short term behavior in our markets generally and explore market based initiatives to address them. For example, what drives companies to issue earnings guidance, while others do not? The other is to look at our disclosure framework and other regulations as a package not as individual items to determine whether they efficiently allow companies to focus on long term performance. For example, can we more efficiently get information to investors that today is included in earnings releases and often repeated in quarterly reports? And does the frequency of our disclosure framework allow companies to focus on the long term performance of their businesses or duly result in quarter to quarter management? I'll deviate from my prepared remarks as I already have many times, but I'll do it again. Mark and I were having a discussion and I want to address this up front. He made a very insightful point. He said, our macro-economic performance does not indicate that we have an excessive short term problem. Whether that is or is not the case let's accept for a moment that it might be. I believe that that may be the result of the substantial shift to private capital. And so we should not only be thinking about whether companies across our economy are managing too much for the short term, but whether this might be an issue that's acute to our public markets and not our private markets and what that means for allocation of capital. With those hard questions but ones that we need to address, I'll turn it over to Commissioner Roisman. And thank you Mark [Roe]. Chairman Jay Clayton, U.S. Securities and Exchange Commission, July 18, 2019.

6. REACH FOR YIELD BY U.S. PUBLIC PENSION FUNDS:

This paper studies whether U.S. public pension funds reach for yield by taking more investment risk in a low interest rate environment. To study funds' risk-taking behavior, we first present a simple theoretical model relating risk-taking to the level of risk-free rates, to their underfunding, and to the fiscal condition of their state sponsors. The theory identifies two distinct channels through which interest rates and other factors may affect risk-taking: by altering plans' funding ratios, and by changing risk premia. The theory also shows the effect of state finances on funds' risk-taking depends on incentives to shift risk to state debt holders. To study the determinants of risk-taking empirically, we create a new methodology for inferring funds' risk from limited public information on their annual returns and portfolio weights for the interval 2002-2016. In order to better measure the extent of underfunding, we revalue funds' liabilities using discount rates that better reflect their risk. We find that funds on average took more risk when risk-free rates and funding ratios were lower, which is consistent with both the funding ratio and the risk premia channels. Consistent with risk-shifting, we also find more risk-taking for funds affiliated with state or municipal sponsors with weaker public finances. We estimate that up to one-third of the

funds' total risk was related to underfunding and low interest rates at the end of our sample period.

Keywords: U.S. public pension funds, reach for yield, Value at Risk, underfunding, duration-matched discount rates, state public debt. Access this paper [here](#). [FRB Boston Risk and Policy Analysis Unit Paper No. RPA 19-2](#), July 17, 2019.

7. AVERAGE CHECKING ACCOUNT BALANCE IN THE U.S.:

Do you ever wonder if you have enough money in your checking account? Or how you stack up with your peers in terms of your [checking account](#) balance? Read on for a breakdown of the average checking account balance in the U.S., as well as how the numbers are affected by age and income. Plus, what to do if your account doesn't quite measure up.

What's the Average Checking Account Balance?

According to data from the [2016 Federal Reserve Survey of Consumer Finances](#), the average checking account balance rings in at around \$10,545, up from \$9,132 in 2013 and \$7,036 in 2010. (The survey is conducted every three years.) Of course, the number on your checking account is also affected by your income bracket. In short, higher earners tend to have higher checking account balances, while lower earners have less in their checking accounts. This could be due to higher earners having more disposable income, therefore, higher balances. Or, it could be attributed to the fact that as your income grows, so does your [cost of living](#). Those who made less than \$25,000 annually kept an average of \$2,018 in their checking accounts in 2016, the survey found, while those who made between \$25,000-\$44,999 had an average balance of \$4,303, and those who made \$45,000-\$69,999 had an average balance of \$6,492. According to the survey, Americans' checking account balances tend to grow along with their income. For example, those who pulled in \$160,000 or more in 2016 had an average checking account balance of \$42,253, more than 20 times that of the lower earners'. Age also makes a difference. The under 35-set had an average of \$4,013 in their checking accounts in 2016, while the accounts of those aged 35-44 more than doubled, at \$9,593. The oldest group surveyed (75-plus) had an average balance of \$15,803. Worth noting: this was just marginally more than the 65-74 set, with an average balance of \$15,752.

So How Much Should I Have in Checking?

The not-so-short answer is: It really depends. While most experts recommend having at least enough in your checking account to [cover a month's bills](#), that amount can vary, depending on your lifestyle and financial obligations. For example, if you are single with no dependents, don't own a car, and have little debt, you may get away with having less in

checking since you won't have to worry about paying for [a costly home or car repairs](#), or the various costs associated with raising a child. However, if you own your own home, are the primary earner in your family, or have children, you may need more cash in your checking account to support your lifestyle. As an aside, it's also a good idea to have an emergency fund of at least [3 to 6 months of living expenses](#), including bills, living expenses, and any debts, so that you're covered in the case of an unexpected job loss or illness. This fund should also be kept in a separate account (usually a [savings account](#)) than from your everyday spending account. However, you may choose to keep only one month's expenses in a savings account, and the rest in an [easy-accessible place, like a Certificate of Deposit \(CD\)](#). After all, if you keep your money in a savings account for the long-term, you will eventually [lose money, thanks to inflation](#). Be sure to talk with your financial advisor to figure out the strategy that's best for you.

How to Grow Your Checking Account

If your checking account balance nowhere near this amount? Don't panic. Here are some strategies to boost your balance.

- Search for a higher-paying job if your current salary doesn't cover all your bills, debt payments, and living expenses. You could also [consider going back to school](#) and earning a new, more lucrative degree.
- Formulate a monthly spending budget and stick to it. Adhering to a budget is one of the best financial moves you can make.
- Consider cutting unnecessary subscriptions. Think cable, [subscription clothing boxes](#), even magazines you no longer read.
- [Sell items you own that you no longer use](#), such as furniture, art, designer clothing, even kitchen appliances on a resale site like Craigslist.

Rachel Morgan Cautero, *The Balance*, March 21, 2019.

8. DID YOU KNOW BENJAMIN FRANKLIN SAID THIS?:

It is the working man who is the happy man. It is the idle man who is the miserable man.

9. PONDERISMS:

Why is it called Quicksand, when it works slowly?

10. INSPIRATIONAL QUOTES:

A man watches his pear tree day after day, impatient for the ripening of the fruit. Let him attempt to force the process, and he may spoil both fruit and tree. But let him patiently wait, and the ripe pear at length falls into his lap. - Abraham Lincoln

11. TODAY IN HISTORY:

On this day in 1945, Vietnam conflict begins as Ho Chi Minh leads a successful coup.

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