

CYPEN & CYPEN NEWSLETTER for December 26, 2019

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

1. CELEBRATING THE FIFTH ANNIVERSARY OF THE ACHIEVING A BETTER LIFE EXPERIENCE ACT:

This month, marks the passage of the Stephen Beck, Jr. Achieving a Better Life Experience (ABLE) Act of 2014, a law that aims to ease financial strains faced by individuals with disabilities.

How can ABLE Help?

ABLE accounts allow people with disabilities that began before age 26 to save and invest private funds without losing eligibility for essential federal government benefits programs, such as Supplemental Security Income (SSI), Medicaid, and housing benefits. Earnings and withdrawals on ABLE accounts are tax-free, if used for qualified disability-related expenses. ABLE accounts can help people with disabilities build financial wellness. In the last five years, ABLE accounts have helped beneficiaries with disabilities achieve greater financial independence:

- Since the program launched in 2016, people with disabilities and their families have saved more than \$300 million to help cover disability-related expenses in ABLE plans offered by 42 states and the District of Columbia.
- ABLE account savings are exempt from the SSI resource limit up to \$100,000. When the balance exceeds that, SSI benefits are suspended until the account balance goes below \$100,000.
- ABLE account owners enjoy the convenience of checking account or debit card savings options to meet regular expenses and some owners save for a rainy day or invest for the future.

To learn more about the program, visit the [NAST](#) website. Michael Frerichs, Social Security Administration, December 19, 2019.

2. MAKE A TAX PAYMENT NOW, AVOID A TAX-TIME SURPRISE:

Taxpayers who paid too little tax during 2019 can still avoid a tax-time surprise by making a quarterly estimated tax payment now, directly to the Internal Revenue Service. The deadline for making a payment for the fourth quarter of 2019 is Wednesday, Jan. 15, 2020. Income taxes are [pay-as-you-go](#). This means that by law, taxpayers are required to pay most of their tax during the year as income is received. There are two ways to do this:

- Withholding from paychecks, pension payments, Social Security benefits or certain other government payments. This is how most people pay most of their tax.
- Making quarterly estimated tax payments throughout the year. Self-employed people and investors, among others, often pay tax this way.

Either method can help avoid a surprise tax bill at tax time and the accompanying penalty that often applies. If a taxpayer failed to make required quarterly estimated tax payments earlier in the year, making a payment to cover these missed payments, as soon as possible, will usually lessen and may even eliminate any possible penalty. The IRS recommends that everyone check their possible tax liability by using the [IRS Tax Withholding Estimator](#). This online tool allows taxpayers to see if they are withholding the right amount and find out if they need to make an estimated tax payment. [Form 1040-ES](#), available on IRS.gov, includes a worksheet for figuring the right amount to pay as well. This is especially important for anyone who owed taxes when they filed their 2018 return. Taxpayers in this situation may include those who itemized in the past but will now claim the increased standard deduction, as well as two wage-earner households, employees with non-wage sources of income and those with complex tax situations. Taxpayers who owed taxes when they last filed and who did not adjust their 2019 withholding may find that they owe taxes again, and even a penalty, when they file their 2019 return next year. Making a quarterly estimated tax payment now can help. In addition, various financial transactions, especially late in the year, can often have an unexpected tax impact. Examples include year-end and holiday bonuses, stock dividends, capital gain distributions from mutual funds and stocks, bonds, virtual currency, real estate or other property sold at a profit. [Publication 505](#), Tax Withholding and Estimated Tax, has additional details, including worksheets and examples, that can be especially helpful to those who have dividend or capital gain income, owe alternative minimum tax or self-employment tax, or have other special situations. The fastest and easiest way to make an estimated tax payment is to do so electronically using IRS [Direct Pay](#) or the Treasury Department's Electronic Federal Tax Payment System ([EFTPS](#)). For information on other payment options, visit [IRS.gov/payments](#). If paying by check, be sure to make the check payable to the "United States Treasury." Though it's too early to file a 2019 return, it's never too early to get ready for the tax-filing season ahead. For more tips and resources, check out the [Get Ready](#) page on IRS.gov. Issue Number: IR-2019-211, December 18, 2019.

3. PRITZKER SIGNS PENSION CONSOLIDATION MEASURE, BUT ALDERMAN WARNS IT'S NOT ENOUGH:

Illinois Gov. J.B. Pritzker signed a measure to consolidate 649 downstate police and fire pension funds into two funds in an effort to boost investment returns and ease pension costs for municipalities and taxpayers. Outside of Chicago, those 649 funds have about \$12 billion in combined unfunded pension liabilities. The average funding ratio for those funds was about 55 percent. Some local governments' entire share of property taxes goes directly into pensions. In some municipalities, it's not enough. The new law passed this fall and takes effect immediately. It was the product of the governor's task force on pension consolidation, which produced a report before the fall session. "This pension task force was really looking specifically at how to consolidate the investment returns for purposes of investment returns and came up with some really good ideas in order to get there," Pritzker said. Local pension boards will continue to make decisions on benefits, the governor said. "Those will be made at the local level by the people who sit on those local boards," Pritzker said. "Those local boards are not going to be making investment decisions however, and that's really, again, how we'll bring billions of dollars into the system." The Illinois Municipal League, a group that lobbies state government on behalf of local governments, supported the bill. "This is a good first step forward on the complicated and comprehensive issue of pension reform," Illinois Municipal League Executive Director Brad Cole said. Statewide police and firefighter groups also backed the measure. However, concerns remain for some in local government. Last week, Springfield Alderman Joe McMenamin said the measure would take away from cities the ability to set an expected rate of return for pension investments. "It's going to be set by the state," McMenamin said. "Now we don't know if they're going to be more conservative, which I hope they will be, or more loose with their rate of return suggestions." If pension investments come in lower than the estimated rate of return when cities budget for annual pension payments, taxpayers are on the hook for the difference. McMenamin also warned that past pension fixes haven't always been successful. "This latest consolidation is not light at the end of the tunnel, in fact, it might be the opposite of light at the end of the tunnel for all we know," McMenamin said. Critics of the measure said it would increase benefits for Tier II pensions adding to costs. The governor's office said the estimated cost is up to \$95 million, but projected investment gains from consolidation could generate between \$820 million to \$2.5 billion by maximizing investment returns. Greg Bishop, The Center Square, December 19, 2019.

4. FLORIDA BILLS WOULD GIVE NEW PARENTS 3 MONTHS PAID LEAVE:

Two bills that aim to give workers three months of paid parental leave are making their way through the Florida state Senate and House. "The Florida Family Leave Act" would require businesses "to allow certain employees take paid family leave to bond with minor child upon child's birth, adoption, or foster care placement." The bills, [SB 1194](#) and [HB 899](#), were introduced by Senator Janet Cruz (D-Tampa) and Rep. Tracie Davis (D-Jacksonville), respectively. "The need for paid family leave has increased as the participation of both parents in the workforce has increased and the number of single parents has grown," [SB 1194 reads](#). "Despite knowing the importance of time spent bonding with a new child, the majority of workers in this state are unable to take family leave because they

are unable to afford leave without pay." To qualify for leave, workers must be employed by the company for at least 18 months. If passed, the legislation would take effect on July 1, 2020. Florida Channel 8 News, December 12, 2019.

5. GOVERNMENT CREDIT RATINGS VULNERABLE TO DOWNSIDE PENSION RISK – – MOODY'S:

While contributions to state and local pension plans are growing steadily, there remains considerable downside risk to the credit quality of sponsoring governments due to volatile investments, said a report from Moody's Investors Service. The report, "Vulnerability to pension investment losses remains high despite slowing costs," said the returns that state and local plans are achieving due to investments in equities and alternatives should lead to stable contribution growth over the next two fiscal years. However, these same investments can also lead to significant downside risk. "Pension investment risk remains a key credit issues for many state and local governments," Tom Aaron, vice president and senior analyst at Moody's, said in a phone interview. "Not all, but many, have downside exposure to capital market performance." The report says that if a market downturn were to occur, it could cause significant credit damage on some governments, especially if combined with a slowdown or decline in revenue. "If, for example, we do get an equity market correction, that would have huge consequences," Mr. Aaron added. Lower interest rates this year have caused adjusted net pension liabilities to increase roughly 22% in 2019 from the year before to \$2.5 trillion among Moody's sample, according to the report. Some governments face substantial credit risk from pension investment losses under the scenario of a moderate downside. In an assumed one-year 6% investment loss scenario, aggregate adjusted net pension liabilities for Moody's sample of 56 state and local plans would rise an estimated 15%. With governments facing increased pension costs since the global financial crisis, the effect on balance sheets would be significantly credit negative for some. Many governments also have less flexibility to defer contribution increases than before the crisis because their pension plans have negative non-investment cash flow via paying out retired participants. "The likelihood of more governments facing severe pension challenges is material," the report said. "Based on the investment volatility risk inherent in U.S. public pension systems' current asset allocations, we assign about a one-in-six probability to our moderate downside scenario." James Comtois, *Pensions and Investments*, December 12, 2019.

6. CALLAN'S DETAILED INVESTMENT MANAGEMENT FEE STUDY HIGHLIGHTS KEY INDUSTRY TRENDS:

Callan has just published the *2019 Investment Management Fee Study*, which provides a detailed analysis on fee levels and trends across multiple asset classes and mandate sizes for both active and passive management. The analysis gives insight into what institutional investors are actually paying (negotiated fees) versus the managers' published fee schedules. The study, the eighth examination of fees we have conducted, reflects trends on 2018 fees paid by Callan clients representing over \$500 billion in assets under management and \$1.8 billion in total fees paid, covering over 350 investment firms and over 165 institutional investors. Here are some of the key trends from this year's survey:

- 98% of total fees paid went to active managers, while 70% of assets were managed actively.
- Fees were concentrated; 50% of total fees went to under 10% of management firms.
- Hedge fund-of-funds had the highest fees: 112 basis points.
- Passively managed U.S. large cap/all cap had the lowest: 2 bps.
- Pricing power was strongest for private real estate and non-U.S. equity products.

In this post, there are a number of new features added for this year's study:

Actual vs. Published Fee Analysis

In addition to comparing the published fees for all products in each asset class category to the actual fees paid for client mandates in that category, this year's study added a comparison to the published fees for only the products in each asset class that have client mandates. This new level of analysis provides insight into the published fees for successful products (*i.e.*, those that received client mandates) and a better understanding of negotiated discounts.

Vintage Analysis

The study examined actual fees by vintage of hiring date to better measure fee trends over the last 20 years.

Industry Concentration Analysis

We examined concentration of assets under management (AUM) and actual fees/revenues by investment firm.

New Asset Classes

This year's study added:

- U.S. mid cap equity
- Emerging market debt
- Multi-asset class (MACs)
- REITs

New Vehicle

In addition to separate accounts, we added collective investment trusts to the study; mutual funds were excluded from the analysis.

New Fee Data

In addition to basis points fees, we analyzed average mandate sizes and average fees paid in dollars to gain insights into the health of the investment management industry. Here's a more detailed look at some of these new features:

Fee Analysis

The fee analysis was done for each asset class and is meant to show current industry fees from three perspectives:

1. Standard “published” fees from the broad universe of all competing products
2. Published fees (pre-negotiation) for only the subset of those products that have Callan client mandates
3. Actual fees paid (after negotiation) for those client mandates

As the chart to the left shows, the goal is to illustrate and compare the fees for the total competitive landscape, the fees for those products successfully winning mandates from Callan clients, and the actual fees those clients ended up paying in 2018.

Vintage Fee Analysis

The vintage fee analysis allowed us to dive deeper into fees for actual client mandates to illustrate the changes in the fee environment over the last 20 years. In order to better display these changes in investment management economics, the analysis focuses on not just changes in average actual fees in basis points (% of AUM), but also changes in average mandate sizes and the resulting changes in average dollar fees per client mandate. Examining fees in both basis points and actual dollars per client gives a clearer picture of how sustained downward pressure on both fee schedules and mandate sizes results in significantly lower dollar fees paid (manager revenue) per client. Showing results in dollars is more illuminating in cases where the average fee in basis points appears stable, but the average mandate size declines materially, resulting in a lower average dollar fee. This analysis groups client mandates into three vintages based on the inception date of the mandate:

- 1999–2008 (10 years pre-Global Financial Crisis)
- 2009–2013 (first 5 years post-GFC)
- 2014–2018 (most recent 5 years)

The vintage groups are further broken down into mandate size ranges. For each vintage and mandate size group we calculate: weighted average fee in basis points, average mandate size in dollars, and average fee per mandate (client) in dollars. Although we use inception vintage groups to differentiate industry fee dynamics over time, it is important to note that the fees being used are the current fees, not necessarily what they were at inception (original fees not reliably available). Since some clients do periodically renegotiate fees with their managers, it is likely that some of the mandates in the older two vintages (particularly the pre-GFC vintage) had higher fees at inception. This means our analysis probably understates fees in the earlier vintages and therefore also understates the downward change in fees from then to now.

Concentration Analysis

The study also conducted a concentration analysis on the actual client fee dataset both at an

industry level (active and passive) as well as asset class by asset class to provide insights into how the competitive pie is being allocated across investment firms by our clients. The results illustrate the number of mandates in each area as well as how many different firms manage those mandates. Concentration of market share in each area with respect to percent of total AUM and percent of total fees is highlighted by showing how many firms control 50% of each. Where relevant we also determine the market share of active vs. passive in an asset class. The full fee study, which includes the detailed analysis for each asset class broken down by mandate size, is available [here](#). Butch Cliff, Callan, December 10, 2019.

7. DID YOU KNOW WILL ROGERS SAID THIS?:

A vision, without a plan, is just a hallucination.

8. INSPIRATIONAL QUOTES:

"You make mistakes. Mistakes don't make you." -- Maxwell Maltz

9. TODAY IN HISTORY:

On this day in 2004, 9.3 magnitude earthquake creates a tsunami causing devastation in Sri Lanka, India, Indonesia, Thailand, Malaysia, the Maldives and edges of the Indian Ocean, killing 230,000 people

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

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