



# CYPEN & CYPEN NEWSLETTER for June 25, 2020

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

## **1. SETBACK ON IMMIGRATION POLICY GOAL LEAVES TRUMP FUMING OVER MAKEUP OF COURTS:**

The Supreme Court protected young immigrants from immediate deportation, but the decision ensured that their long-term fate would remain at the center of a divisive political clash as President Trump fights for another term in the final months of the 2020 election.

The court's opinion, written by Chief Justice John G. Roberts Jr., was a victory for so-called Dreamers, the young immigrants who face deportation and the loss of work permits if the program known as Deferred Action for Childhood Arrivals, or DACA, is terminated. But the court did not say that Mr. Trump could not end it, only that he did not follow the proper rules and procedures in trying to do so.

The president and his hard-line immigration advisers like Stephen Miller must now decide whether to give up or try again -- an effort that would almost certainly extend beyond the election in the fall. But in a series of posts on Twitter, Mr. Trump hinted that he intended to make good on his promise in 2016 to eliminate the program, which he has called an illegal use of executive authority by President Barack Obama.

“Now we have to start this process all over again,” [Mr. Trump wrote](#), calling the court’s opinion “[a highly political one, and seemingly not based on the law.](#)”

For Mr. Trump, no issue is more fraught. Few things would fire up his base more than renewing his plan to deport hundreds of thousands of undocumented immigrants just months before the election. Failing to deliver on that pledge risks alienating his most fervent supporters on the issue that powered his victory to the White House.

Chad F. Wolf, the acting secretary of the Department of Homeland Security, insisted that would not happen. “The DACA program was created out of thin air and implemented illegally,” he said. “The American people deserve to have the nation’s laws faithfully executed as written by their representatives in Congress -- not based on the arbitrary decisions of a past administration. This ruling usurps the clear authority of the executive branch to end unlawful programs.” But the Dreamers are not the gang members he so often claims are part of caravans from Central America arriving at the southwestern border. Most are respected members of society who are in many ways indistinguishable from the American citizens with whom they attended elementary, middle and high school.

And pushing for an end to DACA could alienate swing voters who are critical to Mr. Trump’s hopes for a second term and for moderate Republicans who are crucial to the party’s effort to maintain control of the Senate. Public polls show overwhelming support for the young immigrants, even among Republican voters.

“Is the president going to make the closing argument for his election an effort to strip away DACA and start large scale deportation for the Dreamers?” Todd Schulte, the president of Fwd.us, a business group that advocates on behalf of immigrants, asked Thursday after the ruling. “That is a political loser.” President Trump suggested on Twitter that he intended to deliver on his 2016 promise to eliminate the DACA program.

At the same time, the court’s 5-to-4 decision gives Mr. Trump a new opening to rally his right-wing base by arguing that he needs another four years to stack the courts with conservative jurists who will rule in his favor on immigration, abortion, gun rights and other contentious cultural issues. Since taking office, Mr. Trump -- with the help of Senator Mitch

McConnell of Kentucky, the Republican leader -- has aggressively pushed to install conservative judges on the bench, including two to the Supreme Court: Justices Neil M. Gorsuch and Brett M. Kavanaugh. And the president made clear his work was not done.

“These horrible & politically charged decisions coming out of the Supreme Court are shotgun blasts into the face of people that are proud to call themselves Republicans or Conservatives,” [Mr. Trump tweeted](#) barely an hour after the court announced that he had improperly terminated the Obama-era program.

Senator Tom Cotton, Republican of Arkansas, echoed Mr. Trump in a statement, lashing out at Chief Justice Roberts, who was appointed by President George W. Bush, a Republican, and vowing to make the court an issue in November.

“If the chief justice believes his political judgment is so exquisite, I invite him to resign, travel to Iowa, and get elected,” [Mr. Cotton wrote](#). “I suspect voters will find his strange views no more compelling than do the principled justices on the court.” After the court’s ruling, immigration advocates said they took seriously the president’s threat to once again try to terminate DACA, promising to fight for the permanent legal status of nearly 800,000 young immigrants.

“They may be foolish enough to go after DACA again, but I hope they know and see that America has the DREAMERS’ backs,” Cecilia Muñoz, who served as Mr. Obama’s top adviser on Hispanic issues and domestic policy, [wrote on Twitter](#). She added a warning to the president and his aides about the political power of the pro-immigrant movement.

“We see you, Donald Trump, we see you Stephen Miller,” she said, “and we’re coming for you.” Whatever the president decides to do, the debate over what happens to the Dreamers in the long run will play out most starkly in the presidential contest between Mr. Trump and the presumptive Democratic nominee, former Vice President Joseph R. Biden Jr. Mr. Biden hailed the ruling and vowed to introduce legislation on his first day in office that would give the young immigrants permanent legal status in the United States. Efforts to pass such legislation have failed for more than a decade, but he said the court’s temporary protections raise the stakes of the November election.

“I will continue to stand with DACA recipients, their parents and their families at every step, and in November, joined by millions across this country, we will reject the president who tried to rip so many of our family members, friends and co-workers out of our lives,” Mr. Biden said in a statement.

The issue is already at the forefront of several key Senate races. Hours after the ruling, a Democratic group issued a news release seeking to make an issue out of what they claimed was opposition to DACA by Senator Cory Gardner, a moderate Republican from Colorado.

The group cited two votes to undermine the program that Mr. Gardner took in 2014 and 2015 as a member of the House. “No amount of election season revisionist history from Gardner can change that,” wrote Zach Hudson, a spokesman for the group, American Bridge.

But since becoming a senator, Mr. Gardner has backed bipartisan efforts to find a legislative solution to give Dreamers a permanent legal status, including a path to citizenship. In a statement, Mr. Gardner said he advocated such measures: “I support immediate passage of the Dream Act and would also support the House-passed Dream and Promise Act. The Senate should act quickly to provide permanent relief for Dreamers.”

In Arizona, the court ruling could help efforts by Democrats who are seeking to defeat Senator Martha McSally. Tomás Robles Jr., the co-executive director of Living United for Change in Arizona, said that the temporary nature of the decision created an energy and immediacy around defeating Ms. McSally and blocking Mr. Trump’s re-election. “We have a few months to get him out of office. And if we don’t succeed, he will come with the correct process to eliminate DACA,” Mr. Robles said. Nevertheless, Trump administration officials gave little indication that they were looking for compromise on the issue. Michael D. Shear, *The New York Times*, June 18, 2020.

## **2. ELON MUSK, TESLA BOARD SUED BY PENSION FUND FOR ‘UNRELENTING AVARICE’:**

Tesla Inc. directors, including co-founder Elon Musk, awarded themselves massive compensation packages over a three-year period that improperly siphoned hundreds of millions of dollars out of the electric carmaker’s coffers, a pension fund invested in the company alleges.

The directors -- including Oracle Corp. founder Larry Ellison, James Murdoch, son of media mogul Rupert Murdoch, and Musk’s brother, Kimbal Musk -- wasted corporate assets in granting themselves some of the highest director pay awards among U.S. corporate boards, a pension fund representing Detroit police and firefighters said in a lawsuit filed in Delaware.

Tesla's board members used their positions to "enrich themselves at the company's expense," lawyers for the pension fund said in the 78-page complaint. "They have granted themselves millions in excessive compensation and are poised to continue this unrelenting avarice into the indefinite future." The fund isn't the first Tesla investor to take issue with pay and incentives for Musk and other directors.

An individual Tesla investor argued in a 2018 suit that directors should rescind Musk's multibillion-dollar pay package and the company's board should be shaken up to better protect the carmakers' shareholders. That case is set for trial in October of next year in Wilmington, Delaware. Tesla didn't immediately respond to an email after regular business hours seeking comment on the new suit.

Musk has been a lightning rod over executive compensation ever since he co-founded Tesla in July 2003. In 2018, Tesla shareholders approved a controversial long-term incentive plan that offered the entrepreneur the chance to reap more than \$50 billion from stock-option grants if the company increased its market capitalization to \$650 billion. The directors went overboard on compensation starting in 2017 and didn't stop abusing the system over the next three years, the pension fund alleged.

In 2018, Tesla's two non-employee directors received stock grants worth more than \$8.7 million for the year, and the board chairman -- Australian telecom executive Robyn Denholm -- was the second highest-paid board chair in the U.S., according to the suit. Denholm replaced Musk as board chair as part of a settlement the company reached with the U.S. Securities and Exchange Commission over allegations that the billionaire chief executive's prolific tweeting about the company crossed a line and violated securities laws.

Regulators pounced after Musk tweeted in August 2018 that he had "funding secured" to take Tesla private at \$420 a share. That sent the company's shares up more than 13%. As part of the SEC accord, Musk agreed to have his tweets approved by the company's lawyers.

The fund wants Delaware Chancery Judge Joseph Slights III -- who is handling the other investor case over the Tesla board's pay as well as a legal challenge to the company's buyout of solar-panel maker Solar city -- to find the board's compensation awards were excessive and to make the directors pay back the company. Jef Feeley, Bloomberg, [bloomberg.com](https://www.bloomberg.com), June 18, 2020.

### **3. RESPONDING TO THE COVID-19 CRISIS:**

As of this writing in late March 2020, we are in the midst of a crisis unlike any other in our history. The COVID-19 pandemic has caused economies worldwide to shut down voluntarily. At present, the severity and duration of the disease are unknown; the same is true of the impact on the economies of the U.S. and our global partners. The effect on pension plans will certainly be negative. pension expense and funded status. We will also discuss the impact of the CARES Act on required cash contributions in calendar year 2020. Moreover, we'll also point out some red flags to watch for over the next few years. Finally, we'll detail strategic steps plan sponsors can begin taking now to help mitigate some of the risks in these unprecedented circumstances.

The first quarter of 2020 has been grim for financial markets, with the S&P 500 Index declining nearly 20% and the yield on 10-year Treasury bills falling below 1%. Fortunately, this has absolutely no impact on pension plan obligations or reporting in 2020 for calendar year plan and fiscal years. Cash requirements for underfunded plans with calendar year plan years are based on the valuation results as of Jan. 1, 2019.

They are paid as quarterly installments that the IRS views as a safe harbor amount. So plan sponsors can rest assured that cash projections for the current year will not be affected by recent market events. Furthermore, with the enactment of the CARES Act, all cash contribution requirements for the 2020 calendar year have been delayed to Jan. 1, 2021. This gives plan sponsors the ability to voluntarily make cash contributions during 2020 should they have free cash flow on hand. Now let's look at the impact on the plan sponsor's P&L. These calculations are based on the full calendar year 2019--a period of mixed results but, again, excluding the current market decline. Investment returns were strong in 2019, with assets increasing on average 15.7% as measured by the Milliman 100 Pension Funding Index (PFI).

At the same time, discount rates fell around 110 basis points to historic lows, resulting in liabilities increasing by 17.4% across the PFI. These key inputs interact in different ways when calculating the four principal components of pension. However, Congress responded quickly by passing the CARES Act, which provides a record-shattering \$2 trillion in stimulus--including some immediate relief for plan sponsors. Despite the continued uncertainty, we can offer helpful guidelines for corporate pension plan sponsors based on past experience and the market data that is already in the books through the first quarter of 2020. Specifically, we will address the likely impacts on expense.

Generally speaking, service cost would have increased due to the lower discount rate. Counterintuitively, interest expense could actually have decreased, particularly for plans with low duration in the 7-to-10-year range. Expected return on assets would be higher

due to market appreciation during the year--though tempered perhaps by lower capital market expectations for 2020. Finally, most plans have loss amortizations on their books, and these losses would have likely increased relative to 2019 P&L due to the discount rate declines. The net result is that pension expense would likely have increased for most plans, except those with very short duration, which might actually have experienced an improvement. Funded status declined in 2019 as the increase in liabilities outpaced asset growth. All told, these changes are moderate and well within the normal range of experience. Thus, the backward-looking nature of pension accounting buys plan sponsors valuable time to prepare for obligations that will begin to come due in 2021.

With the passage of the CARES Act, including \$2 trillion in stimulus plus \$4 trillion in liquidity available from the Fed, it's reasonable to expect that the U.S. economy will make it through this crisis. But will asset prices regain the levels of Jan. 1, 2020? And will the discount rate rise enough to take some pressure off of liability valuations? Right now, it appears likely that pension expense and funded ratios will take a hit in 2020.

To make matters worse, additional difficulties are lurking several years ahead as the interest rate smoothing relief, which was introduced in the 2012 MAP-21 bill and extended in the 2014 HATFA bill, is scheduled to phase out between 2021 and 2024. Currently, smoothing effectively mutes the impact of discount rate declines on the calculation of required cash contributions. Starting in 2021, the phase-out would increase the cost of cash contributions significantly each year, possibly even doubling required cash contributions by 2024. This implies that the losses occurring in 2020, should they persist through the end of the year, will impact the cash contribution calculation in 2022--at the exact time that half the benefit of the discount rate smoothing corridor is set to expire.

This is a serious concern. In fact, industry associations are already discussing with Congress the need for further pension reform beyond the CARES Act provisions related to defined benefit plans. Proposals under discussion include extending the current interest rate smoothing provision, deferring extraordinary losses, and freezing PBGC premiums.

A proactive approach for plan sponsors would start with a review of funding projections over the next 5 years, or longer if possible. This would reflect the full widening of the interest rate smoothing corridor, revealing the full extent of changes to the cash contribution from 2019 to 2024.

In addition, plan sponsors could also address optimal contribution deferral and funding strategies in light of the passage of the CARES Act. The plan review should also include best- and worst-case scenarios for market returns so you can model potential impacts on

the P&L. And it may be necessary to consider how retirement plans can be better leveraged to deal with demographic changes resulting from the COVID-19 pandemic. Addressing an increase in the cash requirement is straightforward: The sooner you can put in additional contributions the better. However, with the economic downturn experienced in the first quarter of 2020, many plan sponsors' organizations may be planning other uses of cash. All this could signal consideration of future plan de-risking strategies once the immediate crisis is under control. In conclusion, the key point is not to panic, because you have plenty of time to plan. Under existing rules, cash contributions based on this year's market results would not be affected until 2022.

Now, the CARES Act provides relief from any contributions due this year. It is essential to use this window to make workable plans to fund your contributions requirements over the next 5 years--at a minimum. Based on recent history and comments from key legislators, a second wave of relief from the current, historically low interest rate scenario could already be in the works. Nevertheless, it's best to be prepared for the possibility of challenging times for pension plans over the next several years. Zorast Wadia, CFA, FSA, EA, MAAA, Milliman, [milliman.com](https://www.milliman.com), June 10, 2020.

#### **4. SIMPLE STEPS TOWARD RETIREMENT CERTAINTY IN UNCERTAIN TIMES:**

While the [coronavirus pandemic](#) has put the retirement security of all Americans at risk, there are actions they can take to put themselves in a better position, retirement plan experts say. Catherine Collinson, chief executive officer and president of the Transamerica Institute, says the first thing people should do is formulate a financial strategy for retirement that takes into account their whole financial picture and all sources of retirement income.

The second thing they should do is ensure they have an emergency savings fund to cover their expenses for six months to a year, Collinson says. Americans seem to be embracing this fact, as a recent survey Transamerica conducted identified [emergency savings as the top financial concern](#) of respondents.

"Other things that individuals should be doing, which transcend the current crisis, is to become savvy about finances and saving and investment for retirement," Collinson says. "Many people don't know as much as they should about retirement and investment. There is no time like the present to learn."

Industry authorities agree that understanding even some of the nuances and technical complexities that underpin retirement investing can make a big difference over the long run. Collinson says people don't need to become experts--but they should be asking good

questions and working with someone who is an expert.

“Most are not using a financial adviser,” she says. “It’s an untapped opportunity.” Chad Parks, founder and chief executive officer of Ubiquity Retirement + Savings, says people should make sure their investments are properly allocated for their age and risk tolerance.

Those who are fortunate enough to still be employed should make additional contributions to their retirement plan, says Kalimah White, vice president at TD Wealth. She agrees with Collinson that people who lack an adviser should use calculators and tools to best figure out a financial plan.

Jeanne Fisher, Certified Financial Planner (CFP) Board ambassador, implores people [not to tap into their retirement savings accounts](#) if at all possible. Fisher worries that the current recession will affect older workers more than their younger counterparts, especially because the coronavirus is more prevalent and deadly among those 65 and older. She says she hopes the government will respond by subsidizing some of the income of older Americans who have lost their jobs.

Harry Dalessio, head of institutional retirement plan services at Prudential Retirement, says he hopes that “as we come out of this crisis, sponsors and advisers will realize that the missing piece for retirement plans is [creating a paycheck that will last through people’s retirement](#).”

As the coronavirus exposed the fact that many people do not have an emergency savings fund, Dalessio says he also hopes that more employers will offer “holistic financial wellness programs--covering budgeting, emergency savings and debt management counseling. All of that needs to come into play for a holistic experience.” Lee Barney, *Planadviser*, [www.planadviser.com](http://www.planadviser.com), June 12, 2020.

## **5. RETIREMENT CONFIDENCE SURVEY FINDINGS; FINANCIAL WELLNESS & THE IMPACT OF DEBT:**

The Retirement Confidence Survey is the longest-running survey of its kind, measuring worker and retiree confidence about retirement, and is conducted annually by the Employee Benefit Research Institute (EBRI) and independent research firm Greenwald & Associates. Now in its 30<sup>th</sup> year, the survey also asks about retirement preparations, as well as understanding of the various issues impacting retirement, and products designed to prepare Americans for retirement.

This webinar will discuss the share of workers and retirees who consider debt to be a

problem, and its impact on retirement confidence and one's ability to save for retirement. Overall debt levels for those of different ages will be presented and we'll discuss what is likely to happen with debt after the COVID-19 pandemic.

In addition to saving for retirement, having one's overall finances in order helps prepare workers for retirement, and allows retirees to better navigate their finances once in retirement. Consequently, many employers are adding financial wellness programs to their benefit offerings. The RCS asked workers about their opinions on financial wellbeing programs and their impact on retirement planning. These reflections, and the impact that financial wellness programs can have in helping workers better handle their overall finances, will be discussed. The speakers will also provide their experiences with clients that have these programs, and their clients' areas of focus since the COVID-19 pandemic.

The webinar will take place: **July 28, 2020, at 2:00 p.m. EST.**

Speakers:

- *Craig Copeland*, Senior Research Associate, EBRI
- *Neil Lloyd*, Head US Defined Contribution & Financial Wellness Research, Mercer
- *Lorna Sabbia*, Managing Director, Head of Retirement and Personal Wealth Solutions, Bank of America

Moderator: *Chantel Sheaks*, Executive Director, Retirement Policy Employment Policy Division, U.S. Chamber of Commerce

To register click [here](#). EBRI, [www.ebri.org](http://www.ebri.org), June 2020.

## **6. Bureau of Labor Statistics SHOULD EXPLORE WAYS TO IMPROVE THE ACCURACY, TIMELINESS AND RELEVANCE OF ITS COST-OF-LIVING MEASUREMENTS:**

The U.S. Bureau of Labor Statistics (BLS) faces accuracy, timeliness, and relevancy challenges developing consumer price indexes (CPI) for subpopulations of blue-collar workers and older Americans. For example, the CPI for these workers is used to adjust federal retirement benefits for inflation, including Social Security. BLS has not evaluated the extent to which its existing data are adequate to produce CPIs that reflect what these subpopulations pay, where they shop, and what they purchase. Officials cite budgetary reasons for not having done this, but there may be cost-efficient methods for evaluating the adequacy of these data. Without an evaluation, federal retirement benefits could be subject to adjustment based on potentially inaccurate information. Additionally, BLS has

made limited use of certain data already collected by the federal government--such as National Accounts data on U.S. production and consumption--that could be used to increase the accuracy, timeliness, and relevancy of CPI calculations that reflect the mix of goods and services consumers purchase. Without adequately exploring the potential of using these data, BLS may be missing an opportunity to improve its CPIs.

### **Why GAO Did This Study**

In the United States, federal retirement programs typically include cost-of-living adjustments based on a CPI that measures inflation for a subpopulation of workers. This includes Social Security, which provides benefits for more than 60 million older Americans, workers with disabilities, and their families. As the life expectancy of Americans continues to increase, more Americans will be subject to these adjustments, so it is critical for them to be accurate.

GAO was asked to review U.S. and international efforts to measure the cost of living for older populations. This report examines (1) key issues that BLS faces in measuring the cost of living for older Americans; and (2) the experiences of other countries that developed alternate methods of adjusting retirement benefits. GAO reviewed pertinent literature; assessed BLS efforts to measure inflation; conducted case studies in three countries--Australia, New Zealand, and the U.K.--with a variety of CPIs, which GAO selected based on expert referral and document review; and interviewed agency officials and experts.

### **What GAO Recommends**

GAO recommends that BLS explore cost-efficient ways to evaluate the data currently used to produce subpopulation indexes, and explore the use of National Accounts data to produce more accurate, timely, and relevant CPIs. BLS agreed with the first recommendation but disagreed with the other. GAO continues to believe both recommendations are warranted, as discussed in the report. U.S. GAO, [www.gao.gov](http://www.gao.gov), June 16, 2020.

## **7. DOL OFFERS COMFORT TO 401K PLAN FIDUCIARIES OFFERING PRIVATE EQUITY INVESTMENTS:**

Those responsible for overseeing their company's 401(k) plan may be pleased to learn that recent DOL guidance provides that private equity investments may be offered to plan participants if included as part of a multi-asset class vehicle. The guidance, issued in a June 3, 2020 [Information Letter](#) from the Employee Benefits Security Administration of the Department of Labor (DOL), provides additional factors a prudent plan fiduciary must take into account when deciding to offer an investment option with a private equity component.

Due to their complex and opaque nature, 401(k) plan fiduciaries have typically avoided including private equity investments in designated investment alternatives offered to plan participants. As a result, 401(k) plan participants have not had access to the same investments as actively managed defined benefit plans, which expanded their exposure to private equity following 2006 amendments to ERISA that reduced certain “plan asset” risks associated with those investments. Additionally, defined contribution plans in certain other countries already enable private equity investments.

### **Permitted Investment Alternatives**

The investment alternatives for which the Information Letter provides relief involve asset allocation funds, such as target-date, target risk or balanced funds with a private equity component. In addition to the private equity component, these funds would have a sufficient pool of assets to ensure diversification among other asset classes with different risk and return characteristics. To that end, the fund would have a target allocation of private equity investments that does not exceed a specified portion of the fund’s assets. The remainder of the fund would be invested in liquid assets with readily ascertainable market values, such as publicly traded securities.

The Information Letter provides that the relief would not be available if private equity investments were offered on a stand-alone basis as a vehicle for direct investment by plan participants. Although not explicitly prohibited, the DOL states that these types of investments present distinct legal and operational issues for fiduciaries of ERISA-covered individual account plans. Examples of asset allocation funds that may include a private equity component include both separately managed accounts that are managed by the plan’s investment committee with the assistance of an ERISA Section 3(21) fiduciary, as well as accounts in which a Section 3(38) fiduciary has been delegated investment responsibility. In addition, the plan could offer a pre-packaged “fund of funds,” with one of the underlying funds being a fund that invests primarily in private equity.

As stated above, the asset allocation fund must include sufficient liquid investments with readily ascertainable market values to ensure participants can take distributions and make exchanges among the plan’s investment line-up. Although this requirement ensures the fund would have adequate cash to meet its obligations with respect to its investors and its investments (such as private equity capital calls), an open question remains as to how to value the asset allocation fund on a daily basis. To that end, a prudent fiduciary will need to understand how the private equity component is valued and may consider requiring an independent valuation based on agreed upon procedures in accordance with FASB.

### **Prudent Selection**

ERISA requires that plan fiduciaries prudently select and monitor all designated investment alternatives under the plan. As opposed to publicly traded securities, private equity investments involve more complex structures, longer time horizons, generally higher fees, illiquidity, less stringent disclosure and oversight, as well as an element of subjectivity in regards to valuation. As a result, the Information Letter states that plan fiduciaries evaluating an investment option with a private equity component should consider the following:

- Whether adding the investment option would offer plan participants the opportunity to invest their accounts among more diversified investment options within an appropriate range of expected returns net of fees and diversification of risks over a multi-year period;
- Whether the fund is overseen by investment professionals with the capabilities, experience and stability to manage an asset allocation fund that includes private equity investments;
- Whether the fund has limited the allocation of investments in private equity in a way that is designed to address the unique characteristics associated with such an investment, including cost, complexity, disclosures, liquidity and valuation;
- Whether the fund characteristics align with the plan's features and participant profile (including ages, normal retirement age, anticipated turnover and contribution patterns) and needs; and
- Whether plan participants have been furnished adequate information regarding the character and risks of the investment alternative to make an informed investment decision.

To the extent the plan's fiduciary does not feel it has the skills, knowledge and expertise to make this determination on its own, it must seek assistance from a qualified investment adviser or other professional. Further, the fiduciary must periodically review the investment to determine whether it continues to be prudent and in the best interests of the plan's participants.

### **In Other News**

On June 1<sup>st</sup>, the DOL sent to the Office of Management and Budget for approval a new fiduciary rule, which will once again address the fiduciary responsibilities of those providing advice to retail retirement investors. Although its contents remain a mystery, we expect that the new rule will be less onerous than the rule vacated by the Fifth Circuit of Appeals in 2018 and will more closely adhere to the Securities and Exchange Commission Regulation Best Interest, which is to become effective on June 30, 2020. One area to

keep an eye on is how the rule treats rollover recommendations, and whether such recommendations will constitute covered investment advice. John J. Cannon III, Kenneth J. Laverriere, Doreen E. Lilienfeld, Gillian Emmett Moldowan, Mathew Behrens, Shearman & Sterling, [www.shearman.com](http://www.shearman.com), June 15, 2020.

#### **8. CALPERS CIO EYES MORE PRIVATE EQUITY, LEVERAGE TO HIT TARGET:**

California's giant public pension fund has a giant problem: Its \$400 billion portfolio isn't profitable enough and won't be without a major change in strategy. That's what Chief Investment Officer Ben Meng is about to undertake.

At a meeting of the [California Public Employees' Retirement System](#) (CalPERS) Meng will tell board members that the fund has to take greater risk, he said in an interview. He'll explain that CalPERS must increase its allocation to buyout funds, add private credit and, further departing from its past as a conservative holder of stocks and bonds, use leverage to enhance returns.

"We need unflinching honesty and a willingness to make decisions which are difficult when needed," said Meng, who joined as CIO in January 2019. The new approach contrasts with the emphasis on loss prevention under Meng's predecessor and has potentially far-reaching implications. As the country's largest pension plan, CalPERS is a bellwether for other funds. And as steward for the retirement savings of some 2 million current and former California public servants, it draws plenty of [political scrutiny](#).

CalPERS in February invested [\\$1 billion](#) with [Oak Hill Advisors](#), one of the biggest originators and managers of nonbank loans. Another \$1 billion went in March to distressed-debt specialist [Oaktree Capital](#). Some mandates CalPERS had negotiated with distressed managers before the market's recent correction were triggered, Meng said later at the meeting.

Meng has little choice but to make changes. To meet its future obligations, CalPERS must generate a 7% annual return. Yet an in-house study in 2019 found that its chances of meeting that target over 10 years are just 39%. In a world of historically low yields, the fund would be hard-pressed to hit its goal with \$8 of every \$10 of assets in publicly traded equities and traditional income products.

Without any changes, the long-term return on CalPERS's portfolio is estimated at 6%, meaning the state eventually would need to make up the difference either by requiring public employees to contribute more of their salaries or by using taxpayer funds. The portfolio [lost 4.1%](#) in the nine months through March.

The solution, Meng said, involves raising the fund's current 8% target allocation to private equity "by a few percentage points" and building a small position in private credit over the next three years. CalPERS has preferential access to the best professional investors and needs to exercise that "structural advantage," he said.

Meng's research shows that private equity has the highest expected rate of return, at 8.3%, versus 6.8% for stocks and 2.8% for fixed income. At the same time, CalPERS is redoubling an effort to cut costs by concentrating its business with fewer outside managers and exiting underperforming strategies. Since Meng joined, he has brought \$34 billion in-house, saving CalPERS \$115 million annually in fees.

"As the risk-free rate gets lower and lower, cost savings become more and more important," he said. "There's no volatility around a dollar of savings. That's the highest-quality source of alpha we have." The choices Meng is making are difficult partly because they can result in unanticipated outcomes. One example was his decision in 2019 to end a tail-risk hedging program he considered neither cost-effective nor suitable for a fund CalPERS's size. When the coronavirus pandemic hit and stocks collapsed in March, CalPERS missed out on a \$1 billion payout because it had exited one of the hedges.

Implementing leverage has the most potential to backfire. While borrowing money can boost profits, it can also magnify losses and exacerbate return swings. "We will have to live with the possibility of market drawdowns as the price for increasing the probability of achieving our ambitious target rate of return," Meng said. "There is no alternative."

CalPERS has board approval to borrow \$20 for every \$100 of assets -- nowhere near as much as the typical hedge fund -- and Meng doesn't plan to go that far. He said CalPERS will add leverage via total-return swap agreements, taking equity and Treasury positions in futures and raising cash by lending out securities.

"We plan to deploy leverage regularly and prudently," Meng said at the meeting. There's no certainty that CalPERS will be capable of doing what Meng wants. Already, the fund has struggled to meet its current allocation target for private equity in part because doing so requires investing such large sums.

"We've been trying to ramp up exposure to private markets without compromising our underwriting standards," he said. "We could ramp it up faster, but at a cost." Another item on Monday's agenda is raising CalPERS's allocation to opportunistic strategies to 5% of assets from 3%. Even if Meng succeeds in allocating more money to private assets and

adding leverage, he said CalPERS's chances of hitting its 7% target return over a decade will still be less than 50-50.

"We're not trying to get lucky, just identify what we're good at, mitigate what we're not good at and ignore all the short-term noise by being a patient long-term investor," he said. Erik Schatzker, Bloomberg, [www.bloomberg.com](http://www.bloomberg.com), June 15, 2020.

#### **9. REAL WEEKLY EARNINGS UP 7.4 PERCENT FOR YEAR ENDING MAY 2020, REFLECTING LOSS OF LOWER-PAYING JOBS:**

Real average hourly earnings for all private nonfarm employees increased 6.5 percent from May 2019 to May 2020. The increase in real average hourly earnings combined with a 0.9-percent increase in the average workweek resulted in a 7.4-percent increase in real average weekly earnings over the year. The increases in real average hourly and weekly earnings largely reflect the substantial job loss over the year among lower-paid workers as a result of the COVID-19 pandemic and efforts to contain it.

Real average hourly earnings for production and nonsupervisory employees increased 6.8 percent from May 2019 to May 2020. Real average weekly earnings for these workers rose 8.3 percent over the year. These data are from the [Current Employment Statistics](#) survey and are seasonally adjusted. Earnings for the most recent 2 months are preliminary. For more information, see "[Real Earnings - May 2020](#)." The [Consumer Price Index](#) is used to adjust earnings for inflation. U.S. Bureau of Labor Statistics, [www.bls.gov](http://www.bls.gov), June 19, 2020.

#### **10. ISN'T THIS A TIME WHEN ACTIVE MANAGERS SHOULD SHINE:**

So far, 2020 has provided an interesting opportunity to review the "passive" versus "active" debate. In generally up markets, as we have had for many years, most investors are "relative" investors, meaning they are most interested in how their portfolios perform relative to the broader stock market as a whole. To that end, many turn to passive, index-tracking investments to ensure they are "keeping up with the Joneses." However, when markets turn south, investors' attitudes shift; suddenly, they are more interested in "absolute" returns, protecting their assets as much as possible from the market carnage. Active managers argue this is when their approach can pay off; they say they can be the proverbial lighthouses in the storm, safely guiding a ship (read, investment portfolio) to a sheltered harbor for protection. However, recent data from S&P Dow Jones Indices suggests otherwise.

U.S. equity mutual funds have been under pressure for years. In the period between January 2018 and April 2020, U.S. equity mutual funds suffered \$683 million of net

outflows, while U.S. focused ETFs gathered \$344 million of new money, according to the Investment Company Institute (ICI). While the ICI stats include both passive and active in both categories (U.S. equity mutual funds and U.S.-focused ETFs), a more detailed look at inflows and outflows shows the shift toward ETFs has been driven in part as investors have favored low-cost strategies, especially passive ETFs tracking indexes that have performed relatively well. However, many asset managers have held out hope that investors might return to active managers when market volatility increased, and active funds demonstrated the value of their security selection. In hindsight, the environment in the first four months of 2020 seemed like an ideal time to be an active manager, much like a baseball player seeking a fastball down the middle of the plate to hit out of the ballpark, as equity markets fell into a bear market in March before partially recovering in April. Unlike indexes, active managers can buy or sell stocks at full discretion, picking up favored names that sold off or moving some money to cash based on fundamental and valuation concerns.

So, how did the active managers do? Just over one in three (36%) active domestic equity mutual funds outperformed the multicap S&P 1500 Index in the first four months of 2020, according to S&P Dow Jones Indices. The index provider also released data on active management versus index performance for one year and three years ended March, as well as for different capitalization categories.

Many investors will be disappointed with the active management underperformance highlighted in the S&P Dow Jones Indices data, we think, and the shift toward index-based ETFs is likely to continue in the second half of 2020 and beyond. The case for active management is even weaker on a five- and 10-year basis, but CFRA, an independent investment research firm, cautions investors from relying too much on what seems distant in the rearview mirror. That's why CFRA's fund ranking methodology incorporates an analysis of the holdings inside the portfolio and their likely future prospects, as well as a look at costs and risks of buying and holding any specific mutual fund.

**High fees for active funds make outperforming a challenge.** The average fee for actively managed equity mutual funds shrank in the past two decades but remains quite high relative to index-based alternatives. In 2019, the 0.74% expense ratio for active equity mutual funds was 67 basis points higher than the average index-based equity mutual fund, according to ICI data. Yet this was only modestly lower than the 79 basis point difference in 2000 as index funds also cut expenses over the past two decades.

**CFRA ETF and fund rankings can help investors identify the best choices for their portfolios.** Investors preferring a mutual fund approach to index investing should consider

CFRA four-star-rated Schwab S&P 500 Index (SWPPX) and Vanguard 500 Index (VFIAX), which are rated favorably in part for their low expense ratios--0.02% and 0.04%, respectively--that are well below the 0.93% growth/income category average used in our reports.

[ETF flows](#) has been increasing in recent years, as these products provide liquidity benefits relative to index mutual funds and do not require minimum levels of investment.

**SPDR Portfolio S&P 500 ETF (SPLG)** and **Vanguard S&P 500 ETF (VOO)** charge minuscule 0.03% expense ratios, while investors in **iShares Core S&P 500 ETF (IVV)** incur a 0.04% fee for S&P 500 Index exposure.

**S&P Dow Jones benchmarks are widely followed by ETF investors.** Though investors have a wide array of large-cap index-based ETFs to consider, the funds tracking benchmarks from S&P Dow Jones are dominant. More than \$6 of every \$10 invested in large-cap index-based ETFs at the end of April 2020 track an index from SPGI, including IVV, SPLG, VOO and the slightly more expensive **SPDR S&P 500 ETF (SPY)**, according to First Bridge Data, a CFRA company.

**iShares Russell 1000 ETF (IWB), Invesco QQQ Trust (QQQ) and Vanguard Large-Cap ETF (VV)** are examples of other large-cap funds that track indexes from FTSE Russell (15% market share), Nasdaq (9%) and CRSP (8%). SPGI will continue to benefit, by our analysis, as large-cap investors seek out lower-cost, better-performance alternatives.

## **Conclusion**

While the first four months of 2020 could have been an opportunity for large-cap active managers to hit a home run and showcase their stock selection skill set, just over one in three outperformed the S&P 500 Index in the first four months. Actively managed mid- and small-cap funds demonstrated relative success compared with relevant benchmarks, but high fees relative to index-based mutual funds and ETFs continue to detract from performance. We think the recent trend to shift assets away from actively managed mutual funds to index-based alternatives is likely to persist unabated, with S&P Dow Jones Indices among the major beneficiaries given its market share. Todd Rosenbluth, Wealth Management, [www.WealthManagement.com](http://www.WealthManagement.com), June 11, 2020.

## **11. RELIEF FOR TAXPAYERS AFFECTED BY COVID-19 WHO TAKE**

**DISTRIBUTIONS OR LOANS FROM RETIREMENT PLANS:** The Internal Revenue Service released [Notice 2020-50](#) (PDF) to help retirement plan participants affected by the

COVID-19 coronavirus take advantage of the CARES Act provisions providing enhanced access to plan distributions and plan loans. This includes expanding the categories of individuals eligible for these types of distributions and loans (referred to as “qualified individuals”) and providing helpful guidance and examples on how qualified individuals will reflect the tax treatment of these distributions and loans on their federal income tax filings.

The CARES Act provides that qualified individuals may treat as coronavirus-related distributions up to \$100,000 in distributions made from their eligible retirement plans (including IRAs) between Jan. 1 and Dec. 30, 2020. A coronavirus-related distribution is not subject to the 10% additional tax that otherwise generally applies to distributions made before an individual reaches age 59 ½. In addition, a coronavirus-related distribution can be included in income in equal installments over a three-year period, and an individual has three years to repay a coronavirus-related distribution to a plan or IRA and undo the tax consequences of the distribution.

In addition, the CARES Act provides that plans may implement certain relaxed rules for qualified individuals relating to plan loan amounts and repayment terms. In particular, plans may suspend loan repayments that are due from March 27 through Dec. 31, 2020, and the dollar limit on loans made between March 27 and Sept. 22, 2020, is raised from \$50,000 to \$100,000.

As authorized under the CARES Act, Notice 2020-50 expands the definition of who is a qualified individual to take into account additional factors such as reductions in pay, rescissions of job offers, and delayed start dates with respect to an individual, as well as adverse financial consequences to an individual arising from the impact of the COVID-19 coronavirus on the individual’s spouse or household member. As expanded under Notice 2020-50, a qualified individual is anyone who –

- is diagnosed, or whose spouse or dependent is diagnosed, with the virus SARS-CoV-2 or the coronavirus disease 2019 (collectively, “COVID-19”) by a test approved by the Centers for Disease Control and Prevention (including a test authorized under the Federal Food, Drug, and Cosmetic Act); or
- experiences adverse financial consequences as a result of the individual, the individual’s spouse, or a member of the individual’s household (that is, someone who shares the individual’s principal residence):
  - being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19;
  - being unable to work due to lack of childcare due to COVID-19;
  - closing or reducing hours of a business that they own or operate due to

COVID-19;

- having pay or self-employment income reduced due to COVID-19; or
- having a job offer rescinded or start date for a job delayed due to COVID-19.

Notice 2020-50 clarifies that employers can choose whether to implement these coronavirus-related distribution and loan rules, and notes that qualified individuals can claim the tax benefits of coronavirus-related distribution rules even if plan provisions aren't changed. The guidance clarifies that administrators can rely on an individual's certification that the individual is a qualified individual (and provides a sample certification), but also notes that an individual must actually be a qualified individual in order to obtain favorable tax treatment. Further, Notice 2020-50 provides employers a safe harbor procedure for implementing the suspension of loan repayments otherwise due through the end of 2020, but notes that there may be other reasonable ways to administer these rules.

Employers, financial institutions, and individuals should refer to Notice 2020-50 for more details about how the CARES Act rules for coronavirus-related distributions and loans from plans apply. This tax relief and other information related to the effects of COVID-19 on federal income tax is available on the [IRS Coronavirus Tax Relief pages](#) of IRS.gov. IRS Newswire IR-2020-124, [www.irs.gov](http://www.irs.gov), June 19, 2020.

## **12. AN EXTENSION TO FILE IS NOT AN EXTENSION TO PAY TAXES:**

For most taxpayers the filing and payment deadline was postponed July 15. Those who need more time to file beyond the postponed date, can request an extension to file. Taxpayers must request an [extension to file](#) by July 15. This gives them until October 15 to file their tax return. An extension to file is not an extension to pay. Taxes must be paid by July 15.

### **How to request an extension to file**

To get an extension to file, taxpayers must do one of the following:

- File [Form 4868](#) through their tax professional, tax software or using [Free File](#) on IRS.gov.
- Submit an [electronic payment](#) with [Direct Pay](#), [Electronic Federal Tax Payment System](#) or by [debit, credit card or digital wallet](#) and select Form 4868 or extension as the payment type.

An automatic extension of time to file will process when taxpayers pay all or part of their taxes electronically by the Wednesday, July 15 due date.

Although the tax filing deadline has been postponed to July 15, 2020, the IRS continues processing electronic tax returns, issuing direct deposit refunds and accepting electronic payments.

The agency is now is back to processing paper tax returns sent by mail. However, taxpayers who mailed a paper tax return will likely experience a longer wait time. Those who have already mailed a paper tax return but, it hasn't yet been processed, should not file a second tax return or write the IRS to check the status of their tax return or Economic Impact Payment.

**More information:**

[Coronavirus Tax Relief: Filing and Payment Deadlines](#)

[Coronavirus Tax Relief and Economic Impact Payments](#)

IRS COVID Tax Tip 2020-71, [www.irs.gov](http://www.irs.gov), June 16, 2020.

**13. IRS ALERT - ECONOMIC IMPACT PAYMENTS BELONG TO RECIPIENT, NOT NURSING HOMES OR CARE FACILITIES:**

The Internal Revenue Service today alerted nursing home and other care facilities that Economic Impact Payments (EIPs) generally belong to the recipients, not the organizations providing the care.

The IRS issued this reminder following concerns that people and businesses may be taking advantage of vulnerable populations who received the Economic Impact Payments. The payments are intended for the recipients, even if a nursing home or other facility or provider receives the person's payment, either directly or indirectly by direct deposit or check. These payments do not count as a resource for purposes of determining eligibility for Medicaid and other federal programs for a period of 12 months from receipt. They also do not count as income in determining eligibility for these programs.

The Social Security Administration (SSA) has issued [FAQs](#) on this issue, including how representative payees should handle administering the payments for the recipient. SSA has noted that under the Social Security Act, a representative payee is only responsible for managing Social Security or Supplemental Security Income (SSI) benefits. An EIP is not such a benefit; the EIP belongs to the Social Security or SSI beneficiary. A representative payee should discuss the EIP with the beneficiary. If the beneficiary wants to use the EIP independently, the representative payee should provide the EIP to the beneficiary.

The IRS also noted the Economic Impact Payments do not count as resources that have to be turned over by benefit recipients, such as residents of nursing homes whose care is provided for by Medicaid. The Economic Impact Payment is considered an advance refund for 2020 taxes, so it is considered a tax refund for benefits purposes.

The IRS noted the language in the Form 1040 instructions apply to Economic Impact Payments: “Any refund you receive can't be counted as income when determining if you or anyone else is eligible for benefits or assistance, or how much you or anyone else can receive, under any federal program or under any state or local program financed in whole or in part with federal funds. These programs include Temporary Assistance for Needy Families (TANF), Medicaid, Supplemental Security Income (SSI), and Supplemental Nutrition Assistance Program (formerly food stamps). In addition, when determining eligibility, the refund can't be counted as a resource for at least 12 months after you receive it.”

Additional information about EIPs and representative payees involving Social Security and Supplemental Security Income benefits can be found at [www.ssa.gov/coronavirus/#reppayee](http://www.ssa.gov/coronavirus/#reppayee). Additional information on EIPs can be found at [www.irs.gov/eipfaq](http://www.irs.gov/eipfaq). IRS Newswire IR 2020-121, [www.irs.gov](http://www.irs.gov), June 16, 2020.

#### **14. ROBOCALL REPORTS STILL DOWN, FTC STILL FIGHTING:**

A couple months ago, the Federal Trade Commission (FTC) told you the good news that people had been reporting getting fewer robocalls, and about how some of the FTC's work might have played a part in that. There's more good news -- the number of reported robocalls for April and May were even lower. Maybe you've noticed.

The FTC's latest Do Not Call Registry data shows robocall complaints were down 68% in April 2020 compared to April 2019 and down 60% in May 2020 compared to May 2019. The numbers continued a downward year-over-year trend that started in May 2019. Here are two other interesting points:

- April's and May's number of reported robocalls are the lowest seen in years -- lower than every month since August 2011 (excluding months when [donotcall.gov](http://donotcall.gov) was down due to government shutdowns).
- Robocalls weren't replaced with live calls -- the number of illegal calls from live callers is down, too.

This comes after the FTC and FCC sent more warning letters [in April](#) and [in May](#) to companies providing VoIP services that apparently routed or transmitted illegal

Coronavirus scam robocalls.

These are just the latest actions the FTC has taken to stop illegal robocalls, and there will be more. But it's good to know the actions we take make a difference. The FTC will continue its work with its state and federal law enforcement partners, as well as industry, to reduce unwanted calls. The calls have not stopped. But they will continue to do all they can to protect you from abusive and fraudulent calls. Want to know more about what people are reporting to the FTC? Go to [ftc.gov/exploredata](https://ftc.gov/exploredata).

If you get a robocall, hang up and report it to the FTC at [donotcall.gov](https://donotcall.gov). Then go to [ftc.gov/calls](https://ftc.gov/calls) to learn more about what else you can do to stop them. Lois Greisman, Associate Director, Division of Marketing Practices, FTC, [www.consumer.ftc.gov](https://www.consumer.ftc.gov), June 15, 2020.

**15. DID YOU KNOW ALBERT EINSTEIN SAID THIS?:**

"Small is the number of people who see with their eyes and think with their minds."

**16. INSPIRATIONAL QUOTE:**

"Good things come to people who wait, but better things come to those who go out and get them." -Anonymous

**17. TODAY IN HISTORY:**

On this day in 1788, Virginia becomes the 10th state to ratify the U.S. constitution.

**18. REMEMBER, YOU CAN NEVER OUTLIVE YOUR DEFINED RETIREMENT BENEFIT.**