Registered Investment Advisor Firm

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Happy New Year?

Well the tree fell in the forest – did anybody hear anything? I'm talking about the mid-term election results and how things appear to be taking shape.

In an effort to keep you informed of important changes in or under consideration by legislators, this month I'll address a topic that received very little attention outside the professional money management business.

One of the critically important changes under consideration is a change that could dramatically impact the retirement security of the American middleclass.

While the new Congress won't be seated until later this month, plans appear to be taking shape within the lame-duck session as a little tidbit was placed into the $1.1 trillion omnibus spending bill.

This "tidbit" even has a name and its own website. It's called "Solutions Not Bailouts," and involves a plan to shore up struggling multiemployer pension funds.

While multiemployer pension reform may be needed, there are some troubling points about this plan

To start with, the plan is centered around an idea that hardly seems fair. It allows plan trustees to cut benefits for people who are already retired. How's that for a planning wildcard?

When you're retired and living on a fixed income, it takes some fairly focused planning to make sure at the end of the month you don't have to go three days before your next meal.

That should never happen, because most retirees living on fixed income have little recourse to adjust their financial plans.

We all know how dysfunctional Congress has been over the years and

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the way this plan was vetted is no exception.

Although hearings have been held about this plan over the past two years, no Congressman has ever had to take a specific vote on it. And now it looks like there never will be one.

These plans (multiemployer) are traditional defined benefit pension systems that are jointly funded by groups of employers in such industries as construction, trucking, mining and food retailing.

There's pooled risk in the plans, so they have long been thought to be safer than a single employer plan. This has resulted in a lower level of insurance protection from the Pension Benefit Guaranty Corporation (PBGC).

However, many of the listed industries in the system have seen declining employment and participation rates, and this comes at a time when there's a growing proportion of retirees to workers paying into the pension funds.

Still not sure this is a growing problem? We just have to look to the PBGC who reported recently that the deficit in its multiemployer program rose to $42.2 billion in the fiscal year ending Sept. 30, up from $8.3 billion the previous year. That's over a 500% increase in just one year.

A couple big plans are already close to insolvency: 1) the Teamsters' Central States fund; and 2) the United Mine Workers of America fund.

"Solutions not Bailouts" was developed by the National Coordinating Committee for Multiemployer Plans (NCCMP), its premise is that Congress won't and shouldn't bailout the multiemployer system.

Am I the only one that sees the irony in that?

So instead, the plan calls for a change to the Employee Retirement Income Security Act. They seek to grant plan trustees broad powers to cut retired workers' benefits if they can show that would prolong the life of the plan.

You may think that sounds very reasonable, but let's contrast the change. Currently, the law requires that retirees be paid full benefits unless plan assets are exhausted. Then the PBGC steps in to pay benefits, however at a lower level.

Answer Forum

This month, a question of annuities came up.

Many people don't realize that annuities are insurance products and because of that, there are different accounting standards used for annuities as opposed to publically traded companies.

For instance, individual state regulation forces insurance companies to follow what is known as Statutory Accounting unlike generally acceptable accounting methods (GAAP) which is utilized by publicly owned corporations.

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Statutory accounting is a "show me the money" type of accounting whereby expenses are written off immediately and not capitalized to inflate profits for corporate convenience or even fraud.

That said, most insurance carriers are also publicly traded companies that additionally must also meet GAAP standards.

This means that insurance institutions are required to demonstrate to state regulatory authorities that dollar for dollar a client's premium is safely on deposit in secure financial vehicles such as investment grade bonds or government bonds.

In addition, the insurance carriers are required to have reserves known as "additional surplus reserves," which is the minimum amount of needed capital based on the safety of the investments as determined by state regulators.

Also, each insurance carrier is required to participate in a state insurance guarantee association (SIGA) whereby their insured clients have minimum guarantees on their annuities and life insurance, which typically are no less than $100,000 to $250,000 on annuities and $300,000 on life insurance. Some states have higher minimal limits.

Beyond requiring higher limits, third-party rating agencies examine these insurance institutions and include A.M. Best, Moody's, Standard and Poor's, Fitch, Weiss, The Street and several others.

For the consumer, these ratings can be watched year to year so it is possible to detect a developing problem way before a carrier reaches any serious financial challenge that could affect that carrier's continued viability.

Davis Investment Group

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If have questions or would like further information on this month's topics or any other financial or investment related subjects, including Social Security claiming strategies, please contact me directly at (925) 360-6819 or through my email address at:
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