



- **How Investment Diversification Works**
- **Vermonters Cautioned on Investment Fraud**
- **Health Savings Account Questions Answered**
- **VMERS Membership Requirements Discussed**

Vermont Municipal Employees' Retirement System

July 2009

# Retiring *TIMES*

Volume 9, Issue 1

## State Legislature Passes Adjustment Bill

***Act 24 allows for clarifications in the pension system***

**Very few bills were targeted** toward modifying retirement benefits for municipal employees during this year's session. The Retirement Division, on behalf of the respective retirement boards, introduced a "housekeeping" bill to address areas that required clarity or better definition for the three systems. Below are the sections of Act 24, formerly H. 431, that impact the Vermont Municipal Employees' Retirement System:

The amendment also eliminated the required 90-day absence period after separation of service, and allows the board to determine what the required period of separation should be.

- Language was added to provide the authority for the board to adopt rules to ensure continuing compliance with federal law requirements.

(continued pg. 4)

**We regularly work to make certain that State statutes accurately reflect how the retirement system works in an effort to promote clear communication.**

**—Cynthia Webster, Director of Retirement Policy & Outreach**

- Language was removed that allowed a member to work under the qualifying number of hours for a three-year period and still actively contribute and earn pro-rated service credit. This means that effective July 1, 2009, all members must work a minimum of 24 hours a week, if a year-round employee, and a minimum of 30 hours a week, if a school year employee, in order to earn service credit in the retirement system.
- Language was added that allows a member who elects to transfer back to the defined benefit plan to purchase service accrued in the defined contribution plan. This amendment was added as a result of recent action by the VMERS Board of Trustees to amend the Defined Contribution (DC) Plan document to allow a DC member to elect to transfer back to the defined benefit plan if their employer offers a higher group plan to their employment group.
- Language was added to clarify the consequences if a retiree returns to qualifying employment with a participating municipality. A full description of these consequences is included in the Director's Corner article.

## Does Diversification Still Work?

*Reprinted by permission. Fidelity Viewpoints, June 11, 2009*

**You followed the rules.** You put together a diversified investment portfolio as we—and other financial experts—recommend. Despite that, your portfolio went down along with the rest of the market. Why didn't diversification work? While it may not seem like it, diversification did work. You probably would have lost much more if you hadn't diversified. We'll show you why you shouldn't give up on diversification and why it is still effective.

It helps to know a little bit more about what affects diversification. At the heart of it is "correlation." Simply put, correlation is a measure of how the returns of two investments move together, i.e., whether their returns move in the same or opposite direction and how often. Correlation is a number from -100% to 100% that is computed using historical returns. A correlation of 50% between two stocks, for example, means that in the past when the return on one stock was going up, then about 50% of the time the return on the other stock was going up, too. A correlation of -70% tells you that historically 70% of the time they were moving in opposite directions—one stock was going up and

(continued pg. 4)

# Director's Corner

by Cynthia Webster, Director of Retirement Policy & Outreach

**This article addresses** a frequently asked question: How does a return to work affect the pension I receive from the Vermont Municipal Employees' Retirement System?



I am happy to report that employment with any employer except a municipality that participates in the VMERS has absolutely NO impact on continued receipt of your municipal pension. It doesn't matter how many hours you work, what you earn, or how you earn it, as long as your employer is not a participating municipality. You may even return to work for a participating municipality as long as your regular weekly hours are under the qualifying amount. If you are regularly scheduled for less than 24 hours a week on a year-round basis, or less than 30 hours a week for the school year, then you may work and continue to draw your monthly pension. However, if you return to a job with a participating municipality and work over the minimum number of hours, your monthly pension benefit is impacted in several ways.

- First, your pension will be suspended upon the date of your new hire. You may not draw it while you are actively employed, and you will not be eligible for a cost-of-living adjustment on the pension while suspended.
- Secondly, you will be enrolled as a contributory member of the VMERS under a new membership on the effective date of your return to active employment.
- If you work for a minimum of five years after your new membership is established, you will be entitled to a second pension based on your total creditable service and highest consecutive years of earnings when you once again terminate employment. If you do not work for at least five years under the new membership, you will receive a return of your contributions plus accumulated interest after separation from service.
- Finally, your suspended pension will resume once you again terminate your employment with the municipality. You will not be able to change the option or the beneficiary if you elected a survivorship option on your first retirement. Once your original pension is resumed, if eligible, you will receive regular cost-of-living adjustments.

If you are considering a return to municipal employment in any capacity, it is always good to call the Retirement Office at (802) 828-2305 to learn how it might impact receipt of your pension.

## (Scams Story, Continued)

Besides making personal loans to the man with little or no paperwork to document the transaction, Kalinowski said his father was also persuaded to purchase investment products that didn't mature until his dad was in his late eighties. Following the death of Kalinowski's father in 2007, an investigation into the financial discrepancies resulted in a Bennington-area man being charged with embezzlement and grand larceny. However, the man passed away before a trial could be held.

FINRA maintains a website on investment fraud. The website is located at [SaveAndInvest.org](http://SaveAndInvest.org). For complaints or questions on a specific investment opportunity, Vermonters may contact BISHCA by calling (802) 828-3301 or online at [www.bishca.info](http://www.bishca.info).

# Q&A

## Health Savings Accounts

### **Question: When do you expect the next distribution will be made into the Retiree Health Savings Account?**

When the VantageCare Retiree Health Savings (RHS) Plan was established effective July 1, 2007, the VMERS Board of Trustees developed a formula that requires the system be no less than 102 percent funded in order for money to be distributed into the RHS accounts. Based on the system's investment returns over the past several months, it's unlikely that the funding level will support another distribution in the near future.

### **Question: My account has lost money in the past year - are the ICMA Vantagepoint Milestone Funds still the most appropriate investment vehicle?**

The Board of Trustees took great care in selecting a slate of investment options that would include a well-diversified investment portfolio and provide for optimum growth during active employment and stability with some growth during the retirement years. A recent review of the investment performance of the Vantagepoint Milestone Funds, compared to other targeted lifestyle funds, reflected that they had outperformed their peers over the past year. This means that even though the funds lost money, they lost less money than other funds within their benchmark. Over the long term, the expectation is that the money invested in the RHS accounts will continue to grow.

### **Question: Can I access the money in my RHS account while I am actively employed?**

You may not withdraw money from the account or borrow against the money in the account while you are actively employed. You may access the money once you retire and begin receiving your monthly pension from VMERS. It is important to note that if you should withdraw from the VMERS prior to retirement, you will lose the money in your RHS account. The funds will revert back to the VMERS.

### **Question: If I do not have a spouse at the time of my death, can the balance in my RHS account go to my children?**

According to federal regulations, only a spouse can inherit the money in this type of account. Therefore, it is important that you use the money after you retire to reimburse your medically related expenses such as out-of-pocket deductibles, uncovered vision, dental, hearing or medical bills, or actual health care premiums such as Medicare B, AARP or your employer-sponsored health plan. Also, you may file for reimbursement for either you or your spouse for up to two years after the expense has been incurred and paid.

**IMPORTANT:** If you are currently receiving a VMERS pension and have incurred and paid for any medical expenses, either out of pocket or premiums during the past two years, and have not filed a claim for reimbursement, please call Cynthia Webster at (802) 828-2302 for assistance in completing and filing a claim. The money in your RHS account is FREE money, and is intended to help you with your medical expenses in retirement. Do not allow the money to revert back to the VMERS if it could be paid directly to you instead.

# UPDATES FROM THE RETIREMENT DIVISION: *New Tax Tables & COLA Alert*

## Reality Investing Options Now Available

Participants in the State of Vermont Deferred Compensation 457 Plan may now use a new Reality Investing option. Great-West, the administrator of the 457 Plan, in collaboration with Advised Assets Group, recently launched a suite of investment advisory services. This comprehensive service offers three alternatives to plan participants: online investment guidance free of charge; and for a fee, online investment advice and managed account service. To learn more about these options call your Great-West representative at (800) 457-1028 and select option 2, or locally at (802) 229-2391.



## Alert on New Tax Tables

In February, the American Recovery and Reinvestment Act of 2009 (ARRA) created the new Making Work Pay credit, a refundable tax credit equal to 6.2 percent of earned income up to \$400 (\$800 for taxpayers filing jointly) for the 2009 and 2010 tax years. This credit will be included in workers' paychecks through the adjusted tax withholding tables, but it is not available for pension income, which is considered passive income. Even though the credit does not apply to pension income, we were directed by the IRS to implement the adjusted tax tables. Vermont Retirement Systems implemented the new IRS tax tables beginning with the March 2009 pension payment.

Please note that the change in the tax tables could result in insufficient taxes being withheld from retiree pensions, which could lead to retirees owing Federal tax at the end of the year. If the tax withholding from your retirement allowance decreased due to the new withholding tables or you are concerned that your current withholding will not be sufficient to cover your actual tax liability, you might consider increasing your monthly tax withholding. If you currently have no Federal tax



withholding on your pension, you may not need to take any action. We encourage you to discuss this matter with your tax or financial advisor before making any changes to your withholding. Any retirees who wish to change their tax withholding should complete new tax withholding forms available online at [www.VermontTreasurer.gov/retirement/forms.html](http://www.VermontTreasurer.gov/retirement/forms.html) or by calling the Retirement Division toll-free within Vermont at 1-800-642-3191, or 802-828-2305. All tax withholding changes are due in our office by the 15th of the month in which you want the change to be effective. For example, forms received by August 15 will be reflected in the August 31 pension payment.

## Direct Deposit of Pension Checks

"Direct Deposit" refers to the transfer of money from the Retirement Office directly to your bank account. It eliminates the need for a monthly pension check, which can be stolen, misplaced, or delayed in the mail. The electronic deposit of your monthly pension check ensures that your money will be available to you on the last working day of each month in your bank account, versus waiting an extra day or two for a check to arrive in the mail. It also means less cost to the system as it costs more to prepare checks each month than it does to send the payments electronically. With electronic deposit, your pension check can be directly sent to any bank account (checking or savings) in Vermont or anywhere in the U.S. There is no cost for this service. As of May 2009, approximately 95 percent of all our retirees are utilizing electronic deposit to receive their monthly benefit payments. With over 12,000 retirees in three systems, this means there are still almost 700 pensioners receiving a physical check. For more information or to change to direct deposit, please call 1-800-642-3191. (The toll free number is only available for calls from within Vermont; out-of-state callers must use 802-828-2305.) The form is also available on-line at: [www.VermontTreasurer.gov/retirement/forms.html](http://www.VermontTreasurer.gov/retirement/forms.html). The form will require your signature, your account number and the bank routing number where your monthly pension payment will be received. Forms need to be received at the Retirement Office by the 5th of the month in which you want the direct deposit to take place.

## Update on Cost of Living Increases

Cost-of-living adjustments (COLAs) are applied to all pension payments in January for those who meet the eligibility requirements. The law states that a pension shall be increased or decreased according to the Consumer Price Index (CPI) for the previous June 30. You should be aware that for the first time in recent history, the CPI has been reflecting a negative rate of inflation over the past several months. If the CPI reflects a negative rate on June 30, the COLA that takes effect in January of 2010 will actually result in a reduction in the monthly pensions of those eligible to receive a COLA. Retirees who are eligible for their first COLA would not be impacted, as the law also states that the monthly pension can never go below the original benefit. Final details of the January 2010 COLA will be featured in our December 2009 newsletter.





## (Diversification Story, Continued)

the other was going down. Correlations can change dramatically and rapidly in volatile markets. Assets can become highly correlated, meaning their returns move in the same direction. This reduces the short-term benefit of diversification, which is what happened recently.

### A deeper look at recent markets

The correlations of U.S. stocks to several other types of investments increased during the 2008–2009 bear market. The correlations of U.S. stocks to international stocks and high-yield bonds jumped to nearly 90%. Investment-grade bonds and cash went from being negatively correlated to U.S. stocks to being positively correlated. All of this reduced the effectiveness of diversification during this period.

These changes in correlation aren't surprising—it's happened before. For instance, in the 2002 dot-com bear market, correlations increased dramatically. Compared with the previous 10 years, correlations of U.S. equities to developed world stocks, emerging market stocks, and U.S. high-yield bonds went up from 55%, 61%, and 35% to 85%, 84%, and 56%, respectively. What's different about the recent market decline is the increase in volatility in the markets. During the 2002 dot-com decline, volatility spiked, but not as high as last year. The recent bear market's volatility coupled with increased correlations has heightened the impact on investors' portfolios.

### Diversification has not failed

While it may feel like diversification has failed in recent months, it hasn't. The major asset classes are not perfectly correlated, only more highly correlated. There's a difference—it means that diversification still helped contain portfolio losses, only the benefit was lower than before the market decline. Consider the performance of three hypothetical portfolios: a diversified portfolio of 70% stocks, 25% bonds, and 5% short-term investments; a 100% stock portfolio; and an all-cash portfolio. By the end of February 2009, both the all-stock and diversified portfolios would have declined. The all-stock portfolio would have lost nearly half of its initial value (–48.2%), however, while the diversified portfolio would have lost just over a third (–33.9%). Yes, the diversified portfolio would have declined, but diversification would have helped reduce losses compared with the all-stock portfolio. The all-cash portfolio (0.02%) would have outperformed the all-stock and diversified portfolios over this 14-month period. While short-

term investments performed well last year compared with stocks, investing in all cash limits the future growth opportunities of a portfolio, so it is not an effective long-term strategy.

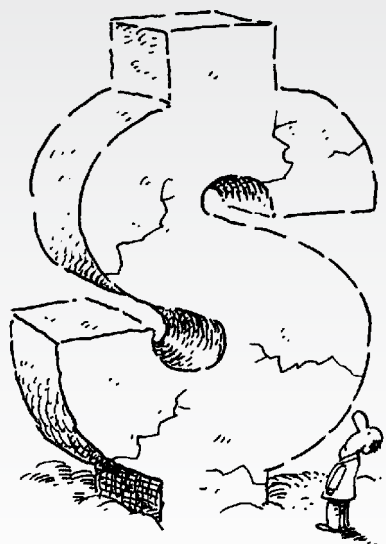
Now let's look at March and April 2009. Our hypothetical all-stock portfolio would have risen by 19.2%, the diversified portfolio by 11.7%, and the all-cash by 0.03%. This is a good example of how such portfolios can behave in rising markets. If the market continues its upward trend, the diversified portfolio may gain less than the all-stock portfolio and more than the all-cash portfolio. This is what diversification is about. It will not maximize gains in rising markets, but it can help limit losses when the market is turning down.

### How to build a diversified portfolio

To start, you need to make sure your investment mix (e.g., stocks, bonds, and short-term investments) is aligned to your investment time frame, financial needs, and comfort with volatility. Next, when

building a diversified portfolio, you want to choose investments whose returns are not likely to move in the same direction, and, ideally, those that move in the opposite direction, i.e., highly negatively correlated. This way, even if a portion of your portfolio is declining, the rest of your portfolio may still be growing. In turn, the overall impact of poor market performance on your portfolio can be dampened. We can

help you determine an appropriate asset allocation and plan for your investment needs. In conclusion, diversification didn't fail in the recent market downturn. It worked—just to a lesser degree. It's important to remember that diversification can only help reduce portfolio risk, not eliminate it.



## (Legislative Update Story, Continued)

- Language was added that provides the authority for the board to offer a dental plan to retirees. As a result, we hope to have a dental plan established and ready for retired member enrollment as early as January of 2010.
- The amortization period for the unfunded liability for the Vermont Municipal Employees' Retirement System was reset for another 29 years. This is a common occurrence in public pension plans when a system is nearing the end of a previously set amortization period in order to maintain contribution rate stability.
- Language was added to correct a previous omission of participants in the group D plan when clarifying how average final compensation will be applied to all levels of accrued service credit at retirement.

## Retirement Board of Trustees

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# Lewis Values Years of Service on Board of Trustees

**Looking back on** more than a decade of service on the VMERS Board of Trustees, David Lewis says he's most satisfied with the work he did to help expand benefits and institute health savings accounts for municipal employees. Lewis retired recently after 32 years as the Killington town manager. Upon his retirement he is required to step down as an employer representative on the VMERS board at the end of his term. He has served on the board since 1998.

**"I have enjoyed serving on the board and looking for alternative ideas and approaches to the issues we faced."**

**-David Lewis**

"We will miss David's ability to see the big picture, his thoroughness and his creative solutions to serving our employers, employees and retirees," said Steven Jeffrey, VMERS Board Chair and Executive Director of the Vermont League of Cities and Towns.

Lewis' dedication to Vermont's municipalities is evident in the many awards he has received. In 1990, the Vermont Town and City Management Association named him Manager of the Year. The Vermont League of Cities and Towns

has twice recognized him. In 1990, he was named Municipal Person of the Year and in 2008 he received a Lifetime Achievement Award.

"Most municipalities in the state are very small and, as such, are unable to provide their own retirement systems for employees," said Lewis. "In the 1970s VMERS was adopted as a means to serve all municipalities. Municipal employees are fortunate to have the system available as a retirement source."

Lewis believes keeping the system financially healthy will be the biggest challenge facing the board in the future. He says to do that the board must maintain a long-term view of revenues versus growth in benefits.

The board and the Treasurer's Office wish Lewis the best in his retirement and thank him for his many years of service.



*David Lewis is stepping down from the VMERS board after 11 years of service.*

## From the Retirement Book: **Membership Requirements**

The Retirement Division has received many questions regarding who is eligible to belong to the Vermont Municipal Employees' Retirement System (VMERS). This article is intended to clarify some of the mystery surrounding that question.

24 V.S.A. § 5051(10) defines "employee" as: "... persons employed on a regular basis by a school district for not less than 1,040 hours in a year and for not less than 30 hours a week for the school year, as defined in section 1071 of Title 16, or for not less than 1,040 hours in a year and for not less than 24 hours a week year-round. The term shall also mean persons employed on a regular basis by a municipality other than a school district for not less than 1,040 hours in a year and for not less than 24 hours per week, including persons employed in a library at least half of whose operating expenses are met by municipal funding."

24 V.S.A. § 5053 (b) states that a "member" is: "Any employee who is hired, subsequent to the effective date of participation of his or her employer, shall become a member of the system on the date the employee is hired."

Let's examine the first definition of "employee." The correct interpretation of this section is to include everyone whose employment group has been offered participation in the VMERS by their municipality, providing they meet the stated hourly requirements. On a regular basis that means that the employee must work a minimum of the qualifying hours for their work schedule (24 hours if a year-round employee and 30 hours if for the school year). This would include elected officials, as well as those hired by the employer, providing the initial vote to offer VMERS didn't limit participation to only a specific group or groups of positions that did not include their employment group. For example, it has recently come to the attention of the Retirement Office that several municipalities throughout the state employ elected Listers who work more than 24 hours a week on a regular basis, yet have not been reported because



**Everyone who meets the hourly requirements is eligible to belong regardless of their title or position.**

it was assumed that elected officials were not eligible to belong to the VMERS. That assumption is incorrect. Everyone who meets the hourly requirements is eligible to belong regardless of their title or position. The only exception to this would be employees who are hired to work for a short period of time, such as seasonal employees, short-term subs, and temporary employees. The expectation must be that the employee will work for at least a year at or above the qualifying number of hours.

Now, let's look at what the term "member" means. ALL employees who meet the definition of "employee" who were hired after a municipality has offered the VMERS to their employment group must begin contributing to the VMERS immediately upon their date of hire or immediately upon the date when they first meet the hourly requirement. Employees who must meet certain employment expectations during a probationary period must still participate in the VMERS during the probationary period. There is only one exception to that rule. Employees who are covered under an existing retirement system may continue to participate in their previous plan provided that plan offers an equal or better retirement benefit than the VMERS. Otherwise, the only employee who may elect not to participate is someone who was hired before the VMERS plan was offered. If you question whether an employee qualifies for membership, please contact Katie McSorley at the Retirement Office for further clarification. Her direct number is (802) 828-5188.

## Vermont Municipal Employees' Retirement System

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# Vermonters Urged to Ask and Check Before Investing

**"If it could happen** to my family, it could happen to any Vermont family." That was one message Vermont State Police Lt. Robert Kalinowski emphasized recently at an educational forum on how to avoid falling victim to investment fraud.

Approximately 300 people attended the June forum that is part of a nationwide educational initiative of FINRA, the Financial Industry Regulatory Authority. FINRA, the State Treasurer's Office, the Vermont Department of Banking, Insurance,

Securities and Health Care Administration, and AARP have launched a statewide campaign to make Vermonters more aware of the growing threat of investment fraud.

**"No one is exempt from this happening to them."**

**-Lt. Robert Kalinowski**

"Americans have lost more than \$2 trillion of their retirement nest eggs and are now desperate to get ready for retirement," said FINRA Foundation President John Gannon. "Unfortunately, that creates the perfect opportunity for scam-artists

to pitch their too-good-to-be-true and get-rich-quick schemes."

Workshop presenters recommended Vermonters practice learning to say "no" and ending the conversation, particularly if it is an unsolicited phone call. If someone does decide to talk to a seller, FINRA recommends the person ask whether the firm or individual salesperson is registered with FINRA, the Securities and Exchange Commission, or with BISHCA—Vermont's State securities regulator. The answers given by the seller should be checked with regulators to make sure they are registered investments. Workshop attendees were urged not to be pressured into making a decision.

In Lt. Kalinowski's situation, it was his father, Robert Sr., who lost thousands of dollars. It was only as his father's health was declining that the Lieutenant and his sister learned their dad had been loaning money to a man he had recently befriended.

"Shortly after my mom was admitted to a nursing home, dad was befriended by a man. The man had local ties to our community and he would go to high school sporting events with dad and treated him very kindly," recalled Kalinowski. "However, he began to borrow money from dad to supposedly use it for his new investment company. As my father's health failed, my sister started helping dad with his accounts and discovered discrepancies in some of the investments and in his checking account statements. It wasn't until dad's friend wouldn't return his calls about the money, that dad realized he had been taken advantage of."

(continued pg. 2)