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Weather or Not, Stay Invested

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2017 was one of the strongest years on record for hurricanes in the Atlantic region of the United States and among the costliest of seasons on record, with preliminary estimates totaling over $200 billion. This is the second largest season in damages since 1900, with 2005 having a slightly higher total (Hurricane Katrina).[1] For those not directly affected by the hurricanes or other extreme weather events, some often wonder how it might affect them indirectly, via their investments. Article upon article is quickly spewed out, some with catchy titles that contain minimal factual content (example: "Investors Brace for Hurricane Irma"). While these articles succeed at garnering clicks, they can also lead investors to act irrationally, thinking they can time the markets or shift investments due to pending storm damages.

Thankfully, there exist some helpful studies that show how markets react to these extreme weather events. The first, from Ishuwar Seetharam at Stanford University, shows that natural disasters do have a small effect on companies who are directly exposed.[2] He looked at over 30 years of data, spanning the top 122 natural disasters. From a timing perspective, the largest effect occurs five days preceding the event to 20 days following. Though this may seem like a no-brainer, other variables can surface which help drive this effect in either direction. For example, if a company has different business lines, or is spread around multiple geographies (to name a few), this can add to or mitigate potential losses.

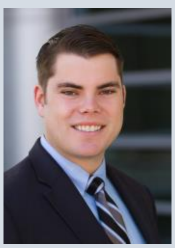
Diving deeper into the markets by industry, Dubravko Lakos-Bujas, from JP Morgan's U.S. Equity strategy team, claims that distributors and construction materials are the top beneficiaries from hurricanes, while energy and insurance companies fare the worst.[3] He arrived at these conclusions by looking at all of the major hurricane landfalls since 1995. As for the overall market, the losses from hurricane damage tend to revert back to normal levels due to ensuing increases in public and private spending.

Despite a lack of strong evidence from the two studies above, there is another idea that comes from no closer than that of left field, albeit from a highly respected individual. Robert Bruner, dean emeritus and current professor of the University of Virginia's Darden School of Business, believes that Hurricane Katrina (2005) triggered the 2008-2009 financial crisis.[4] Like a domino effect, Katrina caused significant damage to housing in the Gulf Coast states, which then triggered credit card delinquencies, and then sub-prime mortgages fell after that. He also claims that other market downturns were triggered by natural disasters, notably referencing the Mississippi flood of 1927 eventually triggering the Great Depression.

One major lesson learned in investing is that you cannot immediately discredit an idea, no matter how unusual it might be. Professor Bruner's claim might sound strange, but perhaps the overarching claim pertains to vulnerability. Some companies, countries and geographic regions are prepared and built to withstand a natural disaster, either physically, financially or some combination of the two. Both studies above show that certain companies and industries can immediately be affected (via-the stock market) if they are not prepared. Also, keep in mind that a particular company's preparedness (or lack thereof) can already be priced into the market. The long-term effects, though intriguing, are very difficult to assess because they seem tangential (i.e. hindsight is 20/20).

If conducting the research on affected companies and industries while also factoring in investor sentiment seems daunting, we believe it is best to remain diversified and hold for the long-term.

[1] *http://time.com/4952628/hurricane-season-harvey-irma-jose-maria/*
[2] *https://web.stanford.edu/~ishuwar/Disasters_Stocks_Current.pdf*
[3] *https://www.marketwatch.com/story/what-history-says-about-hurricane-irma-and-the-stock-market-2017-09-08*
[4] *http://www.cityam.com/277606/floods-hurricanes-and-earthquakes-triggers-financial-crises*



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Tax Reform: A Brief Overview of the Final Legislation

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Article originally appeared on Verrill Dana, LLP | Benefits Law Update Blog (http://www.employeebenefitsupdate.com/).

Congress passed the Tax Cuts and Jobs Act on December 20, 2017, and President Trump signed the bill into law on December 22nd. As everyone knows by now, the new law makes sweeping changes affecting most areas of income taxation. And while the final legislation contained fewer provisions affecting employee benefit plans and executive compensation than the original House Bill, employers will still be faced with a number of significant changes in law -

most of which can fairly be characterized as revenue raisers - that will require careful review of their current arrangements.

Executive Compensation

Publicly traded companies will now have to include "performance-based compensation" for purposes applying the $1 million limitation on the deduction of compensation paid to top executives. Before this year, the deduction limit under Code Section 162(m) excluded performance-based compensation - such as long-term incentive plans and equity compensation grants tied to performance to escape the deduction limit - and pay-for-performance in its many forms became a mainstay of most executive compensation packages. The new law also expands the pool of "covered employees" who will be caught up in the cap by including the CEO, CFO, and the next three most highly paid officers required to be reported to shareholders in the employer's annual proxy statement. In addition, once an executive is classified as a "covered employee" she will continue to be considered a "covered employee" for so long as she receives compensation from the public company. These changes are, of course, intended to reduce the size of the deductions now being taken by public companies for executive compensation and may cause affected employers to rethink the structures of their executive compensation programs.

Tax-exempt organizations face a new excise tax intended to parallel the Section 162(m) cap on deducibility of executive compensation. The new law imposes an excise tax of 21% (the corporate income tax rate starting in 2018) on compensation over $1 million paid by an exempt organization to any of the five most highly paid employees (or former employees). Importantly, compensation will be subject to the new excise tax when it ceases to be subject to a substantial risk of forfeiture (i.e., when it becomes vested). While many exempt organizations already have supplemental executive compensation arrangements in place, the new excise tax may create new incentives for organizations to use SERPs in an attempt to spread out compensation and avoid crossing the $1 million threshold. In addition, tax-exempt organizations will face a new 21% excise tax on "excess parachute payments" made to any of the five highest-paid employees in connection with a separation from service. Excess parachute payments will include any amount that exceeds three times the covered employee's average annual compensation (determined over a look back period) for the prior three years. This generally parallels the provisions of Code Section 280G, which historically did not apply to exempt organizations. Fortunately for tax-exempt hospitals, compensation paid to medical professionals for the performance of medical services will be exempt from these limitations.

The changes to the deductibility of executive pay under Codes Section 162(m) and the new excise tax on compensation paid to executives in tax-exempt organizations will become effective immediately, with no transition period. However, the new rules for public companies under Code Section 162(m) will not apply to compensation under "written agreements" in effect on November 2, 2017, so long as the agreement is not modified in any material respect on or after that date. Public companies should probably avoid making changes to any "pre-existing plan" before further guidance is published.

Deferral of Gain on Qualified Equity Grants

The new law creates an opportunity for employees of non-publicly traded companies to defer for up to five years the recognition of gain from grants of employer stock options or restricted stock units (RSUs). To qualify for the tax deferral under new Code Section 83(i), the stock rights must be granted: (1) in connection with performance of services; and (2) pursuant to a written plan under which at least 80 percent of the company's U.S. employees will receive stock options or RSUs with the same rights and privileges as to the underlying employer stock. The following categories of employees will not be eligible to enjoy the deferral of gain under the new rule: (1) any person who has been a 1% owner of the company at any time during the prior 10 years; (2) the CEO and the CFO of the company; (3) family members of the individuals picked up by the first two categories; and (4) any of the four highest-paid officers for any of the 10 prior years. Importantly, stock rights covered by the new rule will not be eligible for the Section 83(b) election and receipt of qualified stock is not treated as Code Section 409A deferred compensation.

Fringe Benefits and Related Deductions/Exclusions

The new law eliminates or modifies employer deductions and employee income exclusions for:

- Entertainment, amusement, and recreation activities
- Membership dues for a club organized for business, pleasure, recreation, or other social purposes Transportation fringe benefits
- Meals provided to employees for the employer's convenience (deduction reduced to 50% of cost in 2018, with complete elimination beginning in 2026)
- Moving expense reimbursements (income exclusion and deduction available again in 2026)
- Restrictions on deductible employee achievement awards expanded to include cash, gift cards, vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, securities, and similar items

Human resources and payroll departments should team up now to review their fringe benefit arrangements and related pay codes to make the adjustments necessary to comply with the new rules in 2018.

Other Changes

The new law also includes provisions that:

- Eliminate the ability to recharacterize contributions to a Roth IRA as contributions to a traditional IRA and vice versa, and that allows recharacterization to unwind a conversion of a traditional IRA to a Roth IRA
- Allow a tax credit for businesses that provide at least two weeks annual paid family and medical leave to all employees (only available in 2018 and 2019)
- Increase the excise tax on stock compensation in a corporate inversion from 15 percent to 20 percent
- Extend the deadline for rollovers to avoid taxability of retirement plan loan amounts treated as distributions as a result of plan termination or severance from employment from 60 days to the due date for filing the employee's tax return for the year of the deemed distribution
- Allow amounts improperly withdrawn from retirement plans due to an IRS levy to be returned to the original plan or rolled over to an IRA, and requiring the IRS to pay interest on amounts returned or rolled over

We are still analyzing the full impact of the new tax reform law. As we continue to assess the short- and long-term effects of the new law, we will provide updates through future blog posts and client advisories.

Participant Corner: Financial Wellness Series—Part 7: How Long will Your Money Last?

This month's employee memo is the finale of our seven-part series on financial wellness and explores the question, "How long will my money last in retirement?"

The big question when it comes to retirement is, "How much money am I going to need?" With all of the advanced education and strategy tools available, it is still often difficult to understand the difference between what you can save for retirement and what is needed to retire. Sometimes, it is helpful to see what your account can actually provide over the course of your retirement. It can also help you set an achievable goal.

Savings	Monthly income for 10 years[1]	Monthly income for 20 years[1]	Monthly income for lifetime of individual and spouse[2]
$50,000	$493	$289	$174
$100,000	$986	$578	$349
$150,000	$1,479	$867	$523
$200,000	$1,972	$1,157	$698
$250,000	$2,465	$1,446	$872
$500,000	$4,930	$2,891	$1,745
$750,000	$7,395	$4,337	$2,617

The monthly incomes are hypothetical and not intended to project the performance of any specific investment or insurance product.

[1]Payment increases 2% annually to help offset effects of inflation. Illustrative amounts based on 3.5% interest rate. Lifetime payments assume retirement age of 65. Based on 5.5% annual yield compounded monthly. Investment option performance can dramatically affect these numbers. Inflation can also seriously affect the value of the withdrawals. Rate of return is hypothetical and does not represent any specific investment option or imply guaranteed results. Amounts shown do not reflect the impact of taxes on earnings, your actual return will vary depending on your investment option and your tax bracket.
[2]Lifetime payments assume start at age 65 over two lives, Joint and Survivor at 100% survivor benefit and 3% COLA. Analytics provided by MassMutual.