JANUARY 2013

Lawmakers avoided the fiscal cliff, President Obama began his second term, and executive appointments were pushed to the center of a constitutional debate in January. Meanwhile, the administration released some good news on health care spending, while the Government Accountability Office and a member of the Securities and Exchange Commission separately had some negative things to say regarding the Dodd-Frank financial regulations reform law.

ISSUES AND EVENTS

Obama Announces Pick for New Treasury Secretary

President Obama on January 10 nominated Jack Lew, his chief of staff, to be the new secretary of the treasury.

Lew served as director of the Office of Management and Budget (OMB) during the Clinton administration then worked for Citigroup and New York University before taking a series of positions under Obama, including deputy secretary of state, OMB director and, finally, chief of staff.

“Under President Clinton, [Lew] presided over three budget surpluses in a row,” Obama said in making the announcement. “So for all the talk out there about deficit reduction and making sure our books are balanced, this is the guy who did it three times.”

If confirmed by the Senate, Lew will replace Timothy Geithner, a man that Obama said “is going to go down as one of our finest secretaries of the treasury.”

Geithner, a former president of the Federal Reserve Bank of New York, has held the treasury job since the beginning of Obama’s first term and was a key player in the administration’s response to the nation’s sluggish economy. During remarks at the White House announcement of the Lew nomination, Geithner praised his colleagues, his family, Lew and Obama.

"When you stepped into this building as president, you were confronted with a world in crisis, the worst economic crisis in generations," Geithner said. "You made the necessary, the hard and the politically perilous choices that saved the American people and American industry from a failing financial system. Your successful response to the crisis did not solve all of our economic challenges. It could not have done so. But the actions you took, along with those of a forceful and creative Federal Reserve, have made the country stronger and put us in a much better position to face the many challenges still ahead of us."

In other Cabinet news, Health and Human Services Secretary Kathleen Sebelius said that she will stay on the job, and Labor Secretary Hilda Solis, a former congresswoman from California, announced her resignation.

"We have much to be proud of," Solis wrote in a letter to Department of Labor employees. "In the past four years, more than 1.7 million people have completed federally-funded job training programs; of those, more than one million have earned industry-recognized credentials. In addition, Labor Department investments in our community colleges have expanded their capacity to provide local, flexible, employer-specific job training to millions of Americans, and transformed these institutions into engines of economic growth. … We also played an important and active role in crafting regulatory actions to implement key aspects of the Affordable Care Act. Our work will help make President Obama's vision of a health care system that works for America a reality for millions of people."

Obama Announces Pick for SEC Chairman

President Obama on January 24 announced his pick to chair the Securities and Exchange Commission (SEC).

Obama is nominating Mary Jo White, a former U.S. attorney who won convictions against the terrorists responsible for bombing the World Trade Center in 1993 and the U.S. embassies in Tanzania and Kenya in 1998, as well as mafia head John Gotti, to lead the commission.

"There's much more work to be done to complete the task of reforming Wall Street and making sure that American investors are better informed and better protected going forward," Obama said. "And we need to keep going after irresponsible behavior in the financial industry so that taxpayers don't pay the price. I am absolutely confident that Mary Jo has the experience and the resolve to tackle these complex issues and protect the American people in a way that is smart and in a way that is fair."

Some observers have suggested that the appointment indicates a desire by the administration to get tough on financial misbehavior – White would be the first former prosecutor to chair the SEC – but others have said that she is too close to the industry, having served as a director of the Nasdaq stock exchange and on its Executive, Audit and

Policy Committee and, in her role as a partner at Debevoise & Plimpton, having worked as an attorney for JPMorgan Chase and former Bank of America CEO Ken Lewis.

Elisse Walter has led the SEC on an interim basis since former chairman Mary Schapiro resigned in December. If White is confirmed by the Senate, Walter, who was serving on the commission when chosen to be chairman and whose term doesn't expire until December, will return to her previous role as a commissioner.

On January 18, while discussing commission priorities at a meeting of the SEC's Investor Advisory Committee, Walter said that completing work on rules mandated by the 2010 Dodd-Frank financial regulations reform law and the 2012 Jumpstart Our Business Startups (JOBS) Act is "at the top of the list."

Court Ruling Puts Appointment of Consumer Bureau Director in Doubt

A federal court ruling in late January that struck down three appointments by President Obama to the National Labor Relations Board (NLRB) has raised questions about the leadership of the Consumer Financial Protection Bureau (CFPB).

The D.C. Circuit Court of Appeals on January 25 ruled that Obama's late-2011 "recess appointments" to the NLRB were unconstitutional. The recess appointments provision of the Constitution, the court decided, only applies during the recess between sessions of Congress, not during breaks within a given session. It further ruled that, in order for vacancies to be filled in this manner, they must *occur* during a recess, not merely exist during one.

"The appointments structure would have been turned upside down if the president could make appointments any time the Senate so much as broke for lunch," the court ruled.

White House Spokesman Jay Carney criticized the decision, saying it is "novel and unprecedented, and it contradicts 150 years of practice by Democratic and Republican administrations."

On the same day that he made the NLRB appointments, Obama also named Richard Cordray to be director of the CFPB, which oversees mortgages, credit cards, student loans and other consumer financial products. As a result, that appointment, which was already being challenged in a separate lawsuit that also takes aim at other aspects of the Dodd-Frank Act, which created the bureau, is now in question.

The U.S. Supreme Court will probably have the last word. If it upholds the lower court's ruling, hundreds of decisions made by the NLRB since the appointments in question were made could be invalidated. Similarly, if Cordray's appointment is struck down, the CFPB's actions during the past year could be erased.

Obama re-nominated Cordray to the bureau director post the day before the ruling in the NLRB case. Republicans blocked his nomination in 2011, leading to the recess appointment, and seem likely to do so again. GOP lawmakers have heavily criticized the CFPB, in part because they say it is set up to be too independent. They want to replace the director with a five-member commission and make the bureau's annual funding subject to congressional approval. It is now funded through the Federal Reserve. House Financial Services Committee Chairman Jeb Hensarling, R-Texas, said after the ruling that his panel will take up legislation to make those and other changes to the bureau.

"As it is currently structured, the CFPB is the most powerful and least accountable agency in all of Washington," Hensarling said. "Congress and the administration should take this opportunity to make common sense reforms to the CFPB so it is transparent and accountable to the American people."

If Cordray is not confirmed by the Senate and his appointment is not struck down, he will be able to stay in the director position until the end of 2013.

Rules Issued for Less than Half of Dodd-Frank Provisions Requiring Them: GAO

Federal regulators have issued rules for less than half of the Dodd-Frank provisions that require them, according to a Government Accountability Office (GAO) report.

In examining the implementation of the 2010 Dodd-Frank financial regulations reform law, GAO found that the law contains 236 provisions that require the issuance of regulations, and that only 48 percent of those have been completed. Rules have been proposed but not completed for another 29 percent. In some cases, the deadline for the issuance of rules has not been reached, but among the 134 provisions with deadlines no later than December 2012, regulators missed the deadlines for 119.

The agency noted that regulators have attributed delays to the complexity of the issues; the interconnectedness among many of the rules; the heavy volume of public comments received regarding proposed rules; and the need to coordinate between both domestic and foreign agencies.

"Finally, regulators noted that they have prioritized developing responsive, appropriate rules over meeting tight statutory deadlines," the report stated. "As a result, some important rules may take the longest to develop."

The report examined the rule-making process for several issues in detail, including the creation of both the Financial Stability Oversight Council and the Consumer Financial Protection Bureau, new regulations for the $639 trillion over-the-counter derivatives market, and a new prohibition on proprietary trading by banks, commonly referred to as the Volcker rule.

"As of November 2012, staff from some of the regulators responsible for preparing the rules related to proprietary trading and fund investment restrictions told us that they were considering the public comments and next steps, but could not estimate when the next action would occur," the report stated.

SEC Commissioner Takes Aim at Dodd-Frank, Volcker Rule

An SEC commissioner had little good to say about the Dodd-Frank Act during a January 16 speech before the U.S. Chamber of Commerce.

Daniel Gallagher, a Republican who was appointed to the Securities and Exchange Commission (SEC) by President Obama in 2011, said the 2010 financial regulations reform law is "a model of the new paradigm of legislation – a core concept, in this case regulatory reform, overwhelmed by a grab bag of wish-list items."

"What continues to amaze me about the act is not only what it covers in its 2,319 pages, but also the crucial regulatory issues it does not address," Gallagher said. "The juxtaposition of the two is jarring. The act tasks the SEC with a mandate to create unprecedented new disclosure rules relating to conflict minerals from the Congo – but not to reform money market mutual funds, which, we were later told, are ticking time bombs of systemic risk. Dodd-Frank addresses extractive resource payments made by U.S. listed oil, gas and mining companies — but leaves the reform of Freddie Mac and Fannie Mae for another day."

Gallagher said that the law contains about 400 mandates that must be implemented by regulators, which has resulted in the commission "handling ten times its normal rulemaking volume."

"As a result, the SEC, like other regulators, is now dealing with the problem of rushed, inadequate rule proposals that were pushed out in a bid to meet arbitrary congressional deadlines," he said. "As you might expect, it is not easy to promulgate high quality final rules from faulty proposals."

He singled out the Volcker rule for criticism during his speech. When implemented, the rule will prohibit banks from engaging in proprietary trading, but regulators are already six months past the implementation deadline, and Gallagher said that a draft rule that was released in October 2011 unwisely "eschews a focus on smart regulation in favor of pursuing the most vigorous possible interpretation of the rule's mandates."

"The proposal throws the baby out with the bathwater – along with the rubber ducky, the bathtub and all of the plumbing, as well, for good measure," he said. "Rather than carefully examining banks' trading practices to determine which of those practices constitute proprietary trading and which are instead customer-facing activities providing liquidity and reducing the cost of capital, it stretches its definitions of covered activity on an almost punitive basis, as if based on an assumption that any trading that could result in profits for the trading entity must fall within the ambit of the Volcker rule's prohibitions."

Gallagher, who in 2012 said that regulators should "go back to the drawing board" and draft a new rule, added that, "The entire [Volcker rule] rulemaking exercise so far has been carried out in a manner that has wasted the resources of all of the agencies involved."

Total Health Care Spending in U.S. Grows Just 3.9 Percent – Again

Health care spending in the United States increased at a modest rate in 2011 for the third consecutive year, according to statistics released by the Obama administration.

The U.S. spent $2.7 trillion on health care in 2011 – accounting for about 18 percent of the nation's economy – 3.9 percent more than it spent the previous year. This matched the 3.9 percent growth rate in both 2010 and 2009.

Suggested causes of the slower growth – a marked changed from the double-digit health care inflation of previous decades – range from lingering effects of the recession to the impact of provisions of the 2010 health care reform law. The effect of the law is difficult to measure, though, since many of its provisions, including some of its most significant, have not yet been implemented.

"The jury is still out whether all the innovations we're testing will have much impact," Richard Foster, chief actuary at the Centers for Medicare and Medicaid Services, said. "I am optimistic. There's a lot of potential. More and more health care providers understand that the future cannot be like the past, in which health spending almost always grew faster than the gross domestic product."

Increases within various health care sectors were similar to the overall rate, with spending on prescriptions up 2.9 percent to $263 billion, doctors' services 3.6 percent to $436 billion and hospital care 4.3 percent to $851 billion. Medicare spending rose 6.2 percent in 2011, though, significantly faster than the 4.3 percent of 2010.

Separately, the administration released a report that focused on per capita Medicare spending, noting that it increased by just 0.4 percent in 2012. This followed a 3.6 percent jump in 2011 and a 1.8 percent increase in 2010. In this report, the Department of Health and Human Services (DHS) said that the reform law is an "important factor" in the "unprecedented" slow growth of Medicare expenditures. DHS allowed for a possible impact from the economic downturn "as consumers use less care due to its cost. However, as almost all Medicare beneficiaries have supplemental coverage and thus face relatively low out-of-pocket costs, it seems unlikely that consumer behavior alone is responsible for the slow growth in Medicare spending."

The report acknowledged, however, that, even if per capita spending growth remains slow, the increase in the number of retirees will mean that Medicare will account for a growing portion of GDP, so reducing the per capita rate even further will be "an important component of responding to fiscal pressure."

U.S. Lags Behind Other Wealthy Nations in Healthiness, Life Expectancy: NIH

Americans live lives that are both unhealthier and shorter than residents of 16 of the United States' "peer" countries, a study by the National Institutes of Health (NIH) found.

When compared to Canada, Japan, Australia and 13 western European nations, the U.S. ranked last in male life expectancy – 75.64, nearly four years behind first-place Switzerland – and next-to-last in female life expectancy – 80.78, more than five years behind first-place Japan – according to the study. The U.S. led only Denmark in this category.

"Not only are their lives shorter, but Americans also have a longstanding pattern of poorer health that is strikingly consistent and pervasive over the life course – at birth, during childhood and adolescence, for young and middle-aged adults, and for older adults," the report stated. "The U.S. health disadvantage spans many types of illness and injury," including infant mortality, obesity and diabetes, heart disease and six other conditions. "Many of these conditions have a particularly profound effect on young people, reducing the odds that Americans will live to age 50. … And for those who reach age 50, these conditions contribute to poorer health and greater illness later in life."

NIH identified several "likely explanations" for the country's health problems, including a large uninsured population, unhealthy behaviors, high levels of poverty and income inequality, and community designs that encourage automobile use and discourage physical activity.

"The tragedy is not that the United States is losing a contest with other countries, but that Americans are dying and suffering from illness and injury at rates that are demonstrably unnecessary," the report stated. "Superior health outcomes in other nations show that Americans also can enjoy better health. The health disadvantage also has economic consequences. Shorter lives and poorer health in the United States will ultimately harm the nation's economy as health care costs rise and the workforce remains less healthy than that of other high-income countries."

NIH recommended launching public health initiatives aimed at making improvements in the health conditions in which the U.S. trails other nations; educating Americans about how far they lag behind residents of other wealthy countries; and studying the health policies and approaches that other nations have found to be successful.

NCHC-Affiliated Group Recommends Cost-Saving Heath Care Reforms

The Alliance for Health Reform found that there was "general consensus on what should be done broadly to lower health care costs" during a series of briefings the group hosted in 2012.

With health care spending accounting for 18 percent of the U.S. economy – compared to just 5 percent in 1960 – costs have become "immense" and "unsustainable," the organization stated in a report. These expenses, it observed, could lead to higher taxes, reduced GDP, decreased employment and a lower standard of living.

In the report, the group identified at least 11 drivers of health care costs, including lack of care coordination, advances in medical technology, chronic conditions, unhealthy consumer behaviors, and lack of evidence regarding the effectiveness of various technologies. To address these issues, the organization recommended four broad approaches – focus on quality and value; increase patient engagement; place greater emphasis on prevention; and increase the use of what works. These recommendations came with a list of 12 "key elements of addressing health care costs" that included reforming payments and incentives; decreasing waste; improving the use of health information technology; and spending more wisely in generating evidence about treatments.

"Controlling costs while reinventing the health care system," the report observed, "is a never-ending pursuit that requires collaboration among all of health care's key stakeholders."

The Alliance for Health Reform comprises nine groups, including the National Coalition on Health Care, an organization to which CalPERS belongs and which has CalPERS Board Vice President George Diehr as its Board chairman.

The coalition also includes The Commonwealth Fund, which unveiled its own report in January on how to slow health care spending growth by $2 trillion between 2014 and 2023. The Commonwealth Fund's plan sets a goal of holding growth in health care spending to the same rate as the growth in GDP and pursues it using three general approaches: provider payment reforms to promote value and accelerate delivery system innovation ($1.3 trillion in savings); policies to expand options and encourage high-value choices by consumers, who would have access to better information about quality and costs of care ($189 billion); and system-wide action to improve how markets function, including reducing administrative costs and setting national and regional targets for spending growth ($481 billion).

Those three approaches were accompanied by 10 specific strategies, including linking Medicare physician fees to performance measures; enhancing the use of health information technology to gauge clinical outcomes; and reforming medical malpractice policies.

"It is important to note that despite the substantial savings produced by these policies over 10 years, the health sector would still grow – with adequate resources to adopt innovations in care delivery, introduce new medical breakthroughs, and ensure care for an aging population," the report stated. "Even under these policies, health spending is projected to increase from $2.9 trillion in 2013 to $5.1 trillion in 2023 – an increase of more than 75 percent over the decade."

Of the $2 trillion saved by the plan, $1 trillion would be saved by the federal government, $242 billion by state and local governments, $189 billion by employers and $537 billion by households.

The Commonwealth Fund also attempted to identify factors that contribute to high levels of health care spending, and several items on its list overlap the factors noted by the Alliance for Health Reform, including medical technology, chronic conditions and fragmented care with poor coordination.

AARP, AFL-CIO Push for Implementation of Physician Payments Transparency Rule

AARP, AFL-CIO and 17 other groups in January pushed for the Obama administration to implement an overdue program that would make information about payments from pharmaceutical companies and medical device manufacturers to physicians available to the public.

The 2010 Patient Protection and Affordable Care Act directed that manufacturers of drugs and medical equipment that are covered by Medicare, Medicaid or the Children's Health Insurance Program submit records of their payments to physicians to the Centers for Medicare and Medicaid Services (CMS), which would then post them on a public website. Required disclosures would involve payments for food, entertainment, gifts, consulting fees, honoraria, research funding or grants, education or conferences, royalties or licenses, and charity.

Regulations implementing the "Sunshine Act" were to be issued by the Department of Health and Human Services (DHS) by October 1, 2011, with the first reports from drug and device companies to be submitted in January 2012. Both of those deadlines were missed, however.

AARP, the AFL-CIO and the other groups wrote on January 14 that, "There is a significant consequence for healthcare system costs associated with the ongoing delay in implementation because of the practice by some physicians of over-prescribing certain drugs, or by otherwise prescribing medically unnecessary and expensive treatments."

"The Sunshine Act provides patients with the right to know about potential conflicts of interest between their physician and industry, and will help to protect patients from payments or financial relationships that could compromise the quality or cost of their healthcare," they wrote.

CMS on Nov. 27 sent the final version of its rules to the Office of Management and Budget (OMB) for review. That process has not been completed. Following OMB review, CMS will have 90 days to issue the regulations.

A week before AARP, et al., letter, the American Medical Student Association and the National Physicians Alliance sent a similar letter to DHS.

The American Medical Association (AMA), in an October 10 letter to CMS, expressed concerns about the program, objecting to plans to have CMS' Center for Program Integrity manage it. This, the group said, "will cause significant confusion about the purpose of the transparency reports and create a strong perception that anything contained in a transparency report presumptively raises ethical, fraud, abuse, and program integrity concerns." It recommended that another part of the agency have responsibility for the program.

Fiscal Cliff Deal Includes Doc Fix, End of CLASS Act

Congress did more than prevent tax rate increases for most Americans when it passed the "fiscal cliff" deal in early January.

The legislation that made permanent the George W. Bush-era tax cuts for individuals making less than $400,000 and families making less than $450,000 and that postponed for two months a large batch of spending cuts also included a temporary Medicare doc fix and the termination of a long-term care program that never got started.

The Medicare Sustainable Growth Rate formula, which was intended by Congress to automatically set the program's physician payment rates, would have cut payments by 26.5 percent this year in the absence of legislation. The bill that Congress passed on January 1 and the president signed into law (via autopen) on January 2 blocks the cuts through this year.

Congress has annually overridden the SGR calculations during the past decade to avoid payment cuts that, it has been feared, would drive doctors out of the Medicare program.

The latest "doc fix" is projected to cost $25.2 billion over 10 years, and lawmakers are offsetting that expense with a series of cuts to other health-related programs, including recovering overpayments to hospitals for the way services were coded in a certain Medicare program ($10.5 billion) and reducing Medicaid payments to hospitals that treat a large number of uninsured or low-income beneficiaries ($4.2 billion). Chip Kahn, president and CEO of the Federation of American Hospitals, objected to the plan, saying, "It is not in the best interest of patients or those who care for them to rob hospital Peter to pay for fiscal cliff Paul. These cuts could impact hospital services for those who need them the most."

The legislation also dismantles a small part of the 2010 Patient Protection and Affordable Care Act: the Community Living Assistance Services and Supports (CLASS) Act, a voluntary program to which workers could pay into to later be eligible for long-term care benefits of $50 a day. Because of its high projected costs – largely the result of adverse selection problems – the program was quickly disavowed by both parties, with the Obama administration announcing in October 2011 that it would not implement it. Before repeal, the Department of Health and Human Services was technically in violation of the law's requirement that it designate a benefit plan for the program by October 2012.

The fiscal cliff deal also created a panel on long-term care that is to include congressional leaders and White House appointees who will have six months to "develop a plan for the establishment, implementation and financing of a comprehensive, coordinated, and high-quality system that ensures the availability of long-term services." Congress will not be required to vote on or otherwise address the panel's recommendations.

HHS Grants California Insurance Exchange Conditional Approval

The Department of Health and Human Services (HHS) in January granted California and seven other states conditional approval to operate state-based health insurance exchanges.

The 2010 Patient Protection and Affordable Care Act directed that state-based insurance exchanges – HHS has recently started to refer to them as "marketplaces" – be created in 2014 to serve consumers in the individual and small group markets.

So far, 19 states and the District of Columbia have received conditional approval to operate exchanges, either on their own or in partnership with the federal government. The remaining 31 states have until February 15, 2013, to apply for a partnership exchange. (The application deadline for state-only exchanges was December 14, 2012.) In states that do not establish their own exchange or set up a partnership exchange, the federal government will create and operate one.

Also, in January, HHS awarded California $674 million to develop its exchange. California's grant was part of $1.5 billion that was distributed to 11 states during the month.

California has now received $910 million from the federal government to set up its exchange.

Senators Defend Required Disclosure of Energy Company Payments to Foreign Governments

Three senators wrote in a court filing submitted in mid-January that challenges to a provision of the Dodd-Frank Act that requires oil, gas and mining companies to disclose payments to foreign governments should be rejected.

The Securities and Exchange Commission (SEC) adopted a rule in August that requires companies to report when they make payments to foreign governments in order to develop oil and gas fields. The measure was included as the Cardin-Lugar Amendment in the 2010 Dodd-Frank financial regulations reform law to increase the transparency of money flowing to regimes that may be more likely to pocket it than use it for the good of their nation.

The American Petroleum Institute, the U.S. Chamber of Commerce, the National Foreign Trade Council and the Independent Petroleum Association of America are challenging the rules in court, objecting to the SEC's implementation of regulations they say will put them at a competitive disadvantage.

Sens. Ben Cardin, D-Md., and Carl Levin, D-Mich., and former Sen. Richard Lugar, R-Ind., stated in their brief that the law uses "enhanced transparency and integrity in the payment and allocation of resource revenues" to counter the "'resource curse' of … a critical mass of resource-rich countries that are plagued by misallocation of resources, disastrous inequality, the stunting of other domestic industries and endemic corruption."

"Many of these countries are plagued by collapsing governance, upheaval and terrorism," they wrote. "Reliance on such dangerous countries for resources raises the twin specters of insecurity of energy supply and terrorist threats posed by nationals of failed or failing states. … Lack of transparency is well-documented as an enabler of corruption, poor governance, and tax evasion, thus harming citizens of many nations and undermining critical U.S. national security, foreign policy and humanitarian interests."

The plaintiffs in the case argue that the law violates their First Amendment rights to free speech, but the senators reject this claim.

"Resource companies can believe whatever they wish and make any communication they wish about their payments to foreign governments, 'the resource curse,' or the benefits or costs of transparency; they have done so throughout this process," they wrote. "What resource companies may *not* do is impede the power of the legislative branch to require disclosure of objective information to fulfill compelling public policy objectives, including the strengthening of American national and energy security and investor protections."

Major oil companies already disclose some payment information through the Extractive Industries Transparency Initiative, but the senators say that this voluntary program has a "valuable goal" but suffers from "practical inadequacy."

CalPERS in February 2011 wrote to the SEC to support the rule, which was then under consideration by the agency, stating that it "is especially vital for companies operating in countries where governance is weak resulting in corruption, bribery and conflict that could negatively impact the sustainability of a company's operations and our ability to more effectively make investment decisions."

RELATED NATIONAL AND INDUSTRY NEWS

Pew Center Finds Big Municipal Funding Shortfalls for Pensions, Retiree Health Care

Sixty one major cities in the United States face a combined pension and retiree health care funding shortfall of $217 billion, according to a report from the Pew Center on the States.

Pew examined the largest city in each state plus all others with a population of at least 500,000 and found that, as of 2009, they had combined unfunded liabilities of $99 billion for pensions and $118 billion for retiree health care. The cities that were studied represent 45 percent of all municipal employees in the United States.

The report noted that the 2009 data probably do not reflect the entire impact of the recession.

"In addition, cities for the most part have yet to tackle the looming bill for retiree health care, and the strains will be even greater as baby boomers retire in record numbers," the report stated. "Cities also are likely to face greater public scrutiny of retirement costs because of financial reporting changes that soon could make their funding levels look far worse than they do today."

Pew identified three key factors that determined how well cities fared during the economic downturn: fiscal discipline (regularly making the actuarially required contribution); accuracy of investment return assumptions (which are typically around 8 percent a year); and decisions about workers' benefits (ensuring that benefit increases are matched by funding increases).

"The Great Recession may have exacerbated cities' public sector retirement woes, but in most instances it did not cause them," the report stated. "During the downturn, steep market declines hit local pension investments nearly across the board. But cities that entered the recession better funded and those that consistently funded their plans weathered the storm more effectively."

NIRS Report Details Public Pension Investment Process

Public pensions "leverage the advantages of pooled funds, pooled risk, a long investment horizon, and professional money management to reduce the cost of providing retirement benefits to employees over the long term," a report released by the National Institute on Retirement Security (NIRS) in late January stated.

The report detailed the investment process of public defined benefit (DB) pension plans, a subject that has been heavily scrutinized in recent years amid some lower-than-projected investment returns, studies forecasting long-term shortfalls ranging from less than $1 trillion to more than $4 trillion, depending on who is doing the projecting, and new public pension accounting rules issued by the Governmental Accounting Standards Board (GASB).

"We developed this issue brief to provide interested policymakers, journalists and citizens with a basic understanding of how a public pension system manages its investment," NIRS Executive Director Diane Oakley said. "Public pension funds currently hold some $3 trillion in assets under management that provide retirement security for some 19 million workers. So it's critical that stakeholders have access to an accurate overview of the process, including key players, investment policies, risk management, and rate of return assumptions."

The report includes five "key highlights":

- Public pension funds have a clear division of labor for making investment-related decisions. Fiduciary standards apply to each key role in the investment process.

- Public pension funds have rational and systematic processes for setting asset allocation in a diversified portfolio, estimating expected investment returns, and evaluating investment performance.

- The board of trustees of each public DB pension fund determines the acceptable level of risk that is prudent for their plan given its particular circumstances. They then adopt an asset allocation that is designed to maximize returns within the established level of risk.

- The level of risk assumed by public pension funds, as indicated by the percentage of assets invested in equities, is consistent with other institutional investors and with many prudent individual investors.

- Actual investment returns for the overall fund and for the individual portfolios are evaluated over multiple periods including the short term and long term, and evidence indicates that current rate of return assumptions are realistic.

The last point is often the subject of dispute in the public pension debate. Public pensions typically forecast investment returns of around 8 percent a year and base employer and employee contribution amounts on those calculations. Critics, though, say that this assumption is too high, and funds should use a rate of return closer to what could be expected from relatively risk-free investments such as U.S. Treasury bonds – about 4 percent. The NIRS report, however, defended the use of the higher projections.

"On average, public pension funds have met or exceeded the long-term investment return assumptions over the past 20 to 25 years," the report stated. "Current assumptions are also in line with long-run historical experience dating back to the 1920s. Independent studies also indicate that current rate of return assumptions are not unrealistic in light of current capital market conditions."

The report further noted that, as a result of the recent recession and market decline, "public pension funds are incrementally adjusting their rate of return assumptions downwards."

Critics have also charged that public pensions have invested in riskier assets in attempting to offset losses suffered during the economic downturn, but the report rejected this, stating, "Recent data are consistent with the finding that public pensions do not rush toward risk in response to decreased portfolio values."

"The use of alternative investments such as real estate, private equity, and hedge funds is aimed at smoothing out the ups and downs caused by market swings, and increasing overall returns through a more diversified portfolio," the report stated. "Furthermore, public pension fund exposure to these alternative assets, while increasing among larger plans, remains relatively low and is offset by lower exposure to the public equity market."

NASRA Examines Public Employee Pension Contribution Rates

Since 2009, 29 states have increased public employee pension contribution rates, according to a brief analysis released by the National Association of State Retirement Administrators (NASRA) in January.

Employee contributions accounted for 13 percent of public pension revenue between 1982 and 2010, according to a Census Bureau study cited by NASRA. Employer contributions accounted for 27 percent and investment income 61 percent.

NASRA noted the varied approaches that states have taken to revising employee contributions, such as California recently implementing a rate that varies according to the pension plan's actuarial condition. At least five other states use similar calculations.

"A growing number of states," NASRA observed, "are exposing employee contributions to risk – either by tying the rate directly to the plan's investment return, or by requiring hybrid or 401k-type plans as a larger component of the employee's benefit."

GAO Examines Risks, Benefits of Annuities

Notwithstanding their potential benefits, annuities can also present several risks to consumers, the Government Accountability Office (GAO) observed in a report.

GAO analyzed variable annuities with guaranteed lifetime withdrawal benefits (VA/GLWB) and contingent deferred annuities (CDA), two financial products that, generally, allow consumers to receive lifetime payments at a rate guaranteed by an insurance company, even after accumulated assets are exhausted.

GAO noted that consumers buying such products face risks in the process, including "purchasing an unsuitable product, paying too much, making withdrawal decisions that decrease benefits, and having an insurer become insolvent before benefits are received."

The agency noted, in particular, that it often is not easy for consumers to analyze the costs and benefits of the various annuities that are offered.

"Products can function in slightly different ways, have different combinations of features, and charge different amounts for the guarantees," the report stated. "As a result, consumers would find it difficult to take a price quoted to them from one insurer for a specific product with specific features, then compare that to a product from another insurer to determine if they could receive similar benefits at a lower price."

GAO added that insurers also must manage financial risks associated with annuities, especially those related to "when investment returns, interest rates, consumer longevity, and consumer behavior are different from what they expected."

"To the extent that product design and hedging is not sufficient, insurers can also manage financial risks by modifying their products after they have been purchased by consumers to the extent permitted by their contracts, their prior disclosure, and applicable law," the report stated. "For the VA/GLWB and CDA products we reviewed, insurers sometimes reserve certain rights, such as the right to determine which investment funds will be covered by a GLWB rider or CDA guarantee and the conditions surrounding the allocation of a consumer's investment assets, change the frequency and amount of a guarantee fee, or reject additional contributions or transfers."

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

Calif. Rep. Helps to Form Bicameral Climate Change Task Force

A California lawmaker is co-chairing a new House-Senate Task Force on Climate Change.

Rep. Henry Waxman, D-Calif., and Sen. Sheldon Whitehouse, D-R.I., the panel's other co-chair, in late January announced the formation of the group, whose goals include raising awareness about climate change among members of Congress and the public; providing a forum in which to discuss possible solutions; and working to "enact measures that reduce carbon pollution, spur new technologies and enhance efforts to adapt to the harm that climate change is already causing that we will not be able to avoid."

"Our window to act is rapidly closing," Waxman said. "We cannot afford to wait to take action. Once we release carbon into the atmosphere, it stays there for hundreds of years. There's only so much carbon that the atmosphere can hold before the impacts become irreversible. We are fast approaching that point of no return."

President Obama included the topic in his inauguration speech on January 21, saying, "We will respond to the threat of climate change, knowing that the failure to do so would betray our children and future generations. Some may still deny the overwhelming judgment of science, but none can avoid the devastating impact of raging fires and crippling drought and more powerful storms."

Waxman and Whitehouse wrote to Obama on January 24 to commend him for referencing climate change in his speech, notify him of the creation of the task force and ask that he "develop a comprehensive climate change plan as expeditiously as possible."

"Progress in Congress may be so difficult or protracted that you should not hesitate to act," they wrote. "Congress will benefit from knowing what actions you will take administratively to meet your climate pledge and protect the nation. And we will benefit even more from a concerted effort between your administration and your allies in Congress to marshal the latent public support into a political force."

Waxman is one of Congress's leading activists on climate change. As the ranking Democrat on the House Energy and Commerce Committee, he has formally requested that the panel's Republican leadership hold hearings on various aspects of the climate change issue at least 20 times in the past two years. None of the requests has been successful.

On a related matter, Senate Environment and Public Works Committee Chairman Barbara Boxer, D-Calif., on January 22 said that the Environmental Protection Agency (EPA) should take the lead on countering climate change.

"A lot of people don't recognize that EPA has huge authority to reduce carbon in the air," Boxer told reporters. "A lot of you press me … on, 'Where is the bill on climate change? Where is the bill'? There doesn't have to be a bill. There will be many approaches, but I'm telling you right now, EPA has the authority in the transportation sector, in the electricity sector and the industrial sector under the Clean Air Act."

Boxer has unsuccessfully proposed climate change bills in previous sessions of Congress, including proposals that sought to use a cap-and-trade model to limit carbon emissions.