MAY 2014

Issues related to service members dominated the last part of May. Following news that some Veterans Affairs personnel had doctored wait lists, leading to patients not being seen by a doctor for several weeks or months, VA Secretary Eric Shinseki resigned on May 30. And in Afghanistan, Bowe Bergdahl, a soldier who had been held captive by the Taliban for five years, was turned over to U.S. forces in exchange for five prisoners being released from the detention facility in Guantanamo Bay, Cuba. The Obama administration was immediately questioned and criticized about the deal. Many lawmakers, especially Republicans, noted that the White House ignored a legal requirement that Congress be given 30 days' notice before any inmates are released from Guantanamo Bay, and some in the GOP said that the release of Taliban operatives will put Americans in greater danger. The Administration argued that the released men will not pose a significant threat and that Bergdahl was in failing health, which increased the urgency of the prisoner swap. Some current and former members of the military, including some who were in Bergdahl's unit, meanwhile, said that he should be court-martialed as a deserter who walked off his post before his capture.

ISSUES AND EVENTS

SEC Commissioner Compares Public Pension Accounting to Fraud

A Securities and Exchange Commission (SEC) commissioner in May accused public pensions of a "lack of transparency" that "can amount to a fraud on municipal bond investors."

During a May 29 speech at the Municipal Securities Rulemaking Board's Municipal Securities Regulator Summit, Republican SEC Commissioner Daniel Gallagher charged that the liabilities of state and local pension funds have been "hidden from investors" by high projected rates of investment return. He noted that many funds project returns of 7.5 to 8 percent, well above the "risk-free" rate that critics argue should be used, and said that, "Striving to meet this artificial and inflated goal may cause funds to reach for yield, exposing them to increased investment risk and potentially exacerbating the problem."
He added that public pensions make matters worse by valuing expected outflows using

that same 7.5 to 8 percent rate, which he said is "contrary to fundamental tenets of financial economics: liabilities should be valued at a rate that reflects *their* risk, not the risk of the assets that are expected to cover the liabilities."

The public sector typically estimates that total long-term state and local pension shortfalls are around $1 trillion, but critics often put the figure as high as $4 trillion. Gallagher said that public pensions' use of a higher discount rate "is in large part responsible for the hidden $3 trillion in unfunded liabilities that are currently going unreported."

"In the private sector, the SEC would quickly bring fraud charges against any corporate issuer and its officers for playing such numbers games," Gallagher said. "And we would also pursue and punish the so-called fiduciaries who recklessly seek yield to meet unrealistic accounting assumptions. We should not treat municipalities any differently."

Gallagher praised new public pension accounting guidelines from the Government Accounting Standards Board (GASB) that are to be implemented starting in June, but said that more reforms are needed.

"First, entities should value and disclose their liability using a risk-free discount rate, for example, the treasury yield curve, applied to all benefit liabilities," he said. "Second, entities should calculate and disclose a baseline plan contribution - the amount actuarially necessary to fully fund the plan - based on those conservative liability assumptions, along with a conservative estimate of return on investment. Investors would then be able to readily compare financials calculated using GASB standards and disclosures about the current level of plan funding against this common baseline."

FSOC Report Questions Pension Funds' Investment Return Projections

The annual report from the Financial Stability Oversight Council (FSOC) states that public pensions are "notably underfunded," putting the aggregate funding level nationwide at 74 percent and suggesting that even that number might be overstated.

The FSOC, which is comprised of the heads of other federal regulatory agencies, was created by the 2010 Dodd-Frank Act to oversee entities and activities that could pose "systemic risks" to the U.S. financial system. Its report examines all major parts of the U.S. financial system and includes a few brief references to state and local pension plans.

One passage takes a swipe at investment return projections that are used by states and localities, stating just after the reference to the 74 percent funding level that, "public pension funds generally use a different set of accounting rules than private pension funds, enabling them to assume a discount rate based on long-run returns. These estimated long-run returns are significantly higher than average post-crisis returns, and could result in an artificially high funding status."

The report also cites "increased spending pressure from pension liabilities and other post-employment benefits" as one of the primary fiscal challenges for state and local governments.

"Thirteen states contribute less than 80 percent of their annual required contribution to their public pension funds," the report states. "In some municipalities, pension and other post-employment benefits costs are beginning to crowd out other services."

Elsewhere in the report, the council identifies "emerging threats and reforms" in the following areas:

- Short-term wholesale funding markets
- Developments in financial products, services, and business practices
- Risk-taking incentives of large, complex, interconnected financial institutions
- Reforms of reference rates
- Financial system vulnerability to interest rate volatility
- Operational risks
- Foreign markets risks
- Data gaps and data quality
- Housing finance reform

"One of the critical lessons from the financial crisis was recognizing the importance of detecting systemic risks and ways to mitigate them," Treasury Secretary Jacob Lew, the FSOC chairman, said. "The council's annual report is an important part of that ongoing work."

On May 7, Lew testified at a hearing of the House Financial Services Committee, where panel Chairman Jeb Hensarling, R-Texas, expressed concerns about the FSOC's ability to designate some financial firms as systemically important, "and effectively put them into a bailout position." Hensarling urged Lew, in his capacity as FSOC chairman, "to cease and desist with these designations until all our questions [about the FSOC's methodology] can be answered fully and Congress can exercise its oversight authority over this incredible process."

Lew responded that, "FSOC is carrying out a statutory responsibility, and it does it with great care and a process that, I think, has great integrity," to which Hensarling added, "And very little transparency."

Lawmakers Examine Social Security Options

A representative of a libertarian think tank questioned "the extent to which we're actually facing a so-called 'retirement crisis'" in congressional testimony on May 21.

During a hearing on "Strengthening Social Security to Meet the Needs of Tomorrow's Retirees" that was held by the Senate Finance Committee's Social Security, Pensions and Family Policy Subcommittee, Jason Fichtner, senior research fellow at George Mason University's Mercatus Center, referred to media reports regarding "the perception that we are facing a 'retirement crisis,'" a perception, he said, that was strengthened by the financial crisis of the late 2000s and the sluggish recovery from it.

He then asserted, however, that reports of a retirement crisis that are based on retirement income data from the Census Bureau's Current Population Survey - as, he said, such reports often are - may be overstated. In 2008, he said, the survey reported nationwide pension and annuity income of $222 billion, but federal tax filings for that year showed $457 billion in such income.

"Please do not misunderstand me," Fichtner said. "I'm not arguing that everyone has adequately saved for retirement. Nor am I arguing that policymakers shouldn't focus their efforts on public policy options that will help Americans save for their retirement. But I do want to stress that painting all Americans with the broad brush of a 'retirement crisis' creates an incomplete picture of the true financial landscape faced by America's future retirees. Further, I'm concerned that the narrative being told of a 'retirement crisis' is leading us to look toward greater dependence on - and even the expansion of - existing government programs, many of which, Social Security included, are already facing severe financial problems. This is simply not a sustainable plan. We must turn instead toward policy options that will encourage individuals to work, save and invest so that they can build their own financially secure retirement."

Teresa Ghilarducci, chair of the New School for Social Research's Economics Department, though, did not express any doubt that there is a retirement crisis - "Experts agree that almost all middle-class workers working now won't have adequate retirement income even if they try and work well into their late 60s," she said - and she told the subcommittee that this is caused, in part, by only 53 percent of the workforce having access to a retirement plan through their employers.

Ghilarducci said that what is needed is "an expanded Social Security system" and the creation of "a nationwide, individual retirement plan that incorporates the goals of adequate contributions, safe and appropriate investments, and lifetime income."

"No modern nation has found it practical to rely on individuals saving enough for retirement in voluntary, commercial, individual-directed accounts with distorting tax treatments," Ghilarducci said. "The consequences of no change is an underperforming retirement income security system that will result in an increase in elderly poverty rates and a continuing decline in living standards for older Americans, many who have worked 40 or more years."

Maya Rockeymoore, president and CEO of the Center for Global Policy Solutions, referenced "the significant deficiencies of 401(k) accounts" and "structural inequalities in our labor market that shut millions of workers out of non-Social Security retirement savings," and focused on enhancements that can be made to Social Security in her testimony.

"Efforts to strengthen Social Security should not only focus on the program's solvency, they must also consider how to increase the adequacy of benefits for vulnerable populations, and how to modernize the program to meet changing population needs," Rockeymoore said. "In recognition of this need, a growing number of experts, policymakers and advocacy organizations are calling for the expansion of Social Security, the only near-universal, portable and affordable retirement vehicle accessible to most of America's working-age population."

Stephen Goss, chief actuary for the Social Security Administration (SSA), reviewed the program's finances, noting that, in the absence of reforms, its trust fund is projected to be exhausted by 2033.

"Changes are needed soon to avert trust fund reserve depletion and an abrupt reduction in the level of benefits payable with scheduled income," Goss said. "The Congress, on behalf of the American people, will need to decide whether to, one, maintain currently scheduled benefit levels, which would require increasing program revenue from 4.5 to 6 percent of GDP; two, reduce scheduled benefits by 25 percent; or three, implement some combination of these options."

Goss noted that "a wide variety of possible changes to the Social Security Act" have been proposed, and, without mentioning any specifically, he referred lawmakers to a page on the SSA's website that includes estimates of the financial impact of several of those proposals, one of which would require Social Security coverage of all newly-hired state and local government employees. This would cover an estimated 5.5 percent of Social Security's long-term actuarial shortfall.

Young Adults 28 Percent of Health Insurance Exchange Enrollments: HHS

The Obama administration's late push for health care exchange enrollments not only increased the overall numbers, but also boosted the percentage of young adults signing up for coverage, according to the Department of Health and Human Services (HHS).

The 2010 Patient Protection and Affordable Care Act established state-level exchanges to provide marketplaces in which people who cannot get affordable group coverage can buy insurance. The federal government operates exchanges through www.healthcare.gov in 36 states that chose not to establish them, while 14 states and the District of Columbia run their own exchanges.

In a report on the exchanges' October 1, 2013-to-March 31, 2014 open enrollment period, HHS found that 8,019,763 people signed up for coverage. The total includes 910,495 enrollments that occurred April 1-19 by people who had qualifying life events that allowed them to sign up outside the normal open enrollment period and people who started - but did not complete - the enrollment process before the deadline.

California, which operates its own exchange, had the most enrollments, with 1,405,102. Florida was second at 983,775, and Texas was third at 733,757.

The healthcare.gov website got off to a rough start, with technical problems limiting enrollments to fewer than 365,000 through the first two months after the October 1 launch. Nearly half of all enrollments - 47 percent - occurred from March 1 on. During the final month, the percentage of enrollees who were between the ages of 18 and 34 increased to 31 percent. This raised the percentage of young adults who signed up for coverage during the six-month enrollment period to 28 percent, up from 24 percent. Although this is still below the 40 percent target that had been mentioned by some as being the threshold at which the risk pool would be sustainable without significant premium hikes, officials expressed satisfaction with the results.

"We believe, based on the data we've seen and independent data, that premiums will be stable and that the risk pool is sufficiently large and varied to support that kind of pricing," HHS Office of Health Reform Director Mike Hash said, according to *The Hill*.

The totals reflect people who have signed up for a plan, but not all enrollees have paid their first premiums. The report noted that the Centers for Medicare and Medicaid Services (CMS) "does not yet have comprehensive and accurate data" about how many people have paid for coverage, but "some issuers have made public statements indicating that 80 percent to 90 percent of the people who have selected a Marketplace plan have made premium payments."

Republicans have regularly challenged the administration's enrollment numbers, and GOP members of the House Energy and Commerce Committee on April 30 released a report that concluded, based on their outreach to insurance providers that participate in the federally-operated exchanges, that "only 67 percent of individuals and families that had selected a health plan in the federally facilitated marketplace had paid their first month's premium and therefore completed the enrollment process." One fourth of paid enrollees are between the ages of 18 and 34, according to committee Republicans.

Democrats on the panel, however, released a memo on the same day that asserted that, since premiums for more than 3 million enrollees had not yet come due at the time Republicans collected the information, "The data underlying this [67 percent] claim is so flawed that it is essentially worthless."

"The Republican analysis is rubbish," Rep. Henry Waxman of California, the committee's ranking Democrat said. "It is inaccurate, irresponsible and out-of-date. It is another in a long line of Republican false allegations and scare tactics about the Affordable Care Act."

GOP Senators Question CMS About Oversight of State Exchanges

Two senior Republican senators wrote to the Centers for Medicare and Medicaid Services (CMS) in May to express concern about the "massive amount of taxpayer dollars being spent on failing health care exchanges."

The 2010 Patient Protection and Affordable Care Act established state-level exchanges to provide marketplaces in which people who cannot get affordable group coverage can buy insurance. The federal government operates exchanges through www.healthcare.gov in 36 states that chose not to establish them, while 14 states and the District of Columbia run their own exchanges.

In a May 15 letter to CMS Administrator Marilyn Tavenner, Sens. Charles Grassley, R-Iowa, and Orrin Hatch, R-Utah, noted that Maryland, Massachusetts and Oregon recently announced that they are scrapping the exchanges that they had created because of massive technical problems, with the latter two states planning to move to the federally-operated exchange. Nevada, they also observed, appeared likely to soon do the same. Almost $5 billion in grants have been disbursed to states to fund the establishment of exchanges, they asserted, and "nearly half of the state exchanges still have significant problems that have rendered them virtually unusable and may ultimately prove to be unfixable."

"The government has a responsibility to spend money responsibly and conduct oversight to ensure it is well used," Grassley and Hatch wrote. "It appears that the government is not carrying out its duty in the case of the state exchanges."

The lawmakers asked Tavenner to answer 10 questions about CMS' oversight of the state exchanges - particularly those in Maryland, Massachusetts, Oregon and Nevada - and the federal funding that went to them by May 30.

Hatch is a cosponsor of the “State Exchange Accountability Act,” legislation that was introduced on May 14 by Sen. John Barrasso, R-Wyo., that would require states that abandon their own exchanges and move to the federal one to repay all funding they had received for the exchanges from the federal government.

Senate Panel Approves HHS Nominee

The Senate Finance Committee in May gave its approval to the nominee to become the next Secretary of Health and Human Services (HHS).

Office of Management and Budget (OMB) Director Sylvia Mathews Burwell was nominated by President Obama in April to succeed Kathleen Sebelius as HHS secretary.

Burwell breezed through a Senate Health, Education, Labor and Pensions Committee hearing on May 8 and a Finance Committee hearing on May 14.

The Finance Committee voted 21-3 on May 21 to approve her for the post. All 13 of the panel's Democrats and eight of its 11 Republicans voted for her. Burwell now awaits a confirmation vote by the full Senate, which is expected on June 5.

"There are significant challenges to address in health care, child welfare and family service, so Ms. Burwell will need to hit the ground running at HHS," committee Chairman Ron Wyden, D-Ore., said. "That's why it's so important for the Senate to take up Ms. Burwell's nomination promptly. She will be a force for bringing people together in a bipartisan way and forging common ground."

Burwell's confirmation appears to be all but certain, as even some Republicans have expressed support, with Finance Committee Ranking Republican Orrin Hatch of Utah, for example, saying that Burwell is an "excellent choice."

Before the committee vote, Sen. David Vitter, R-La., was the only senator to publicly indicate that he will vote against Burwell, stating in a May 19 letter to three House colleagues that he will oppose the nomination "until an agreement is reached to provide the American people the same treatment under Obamacare as large businesses." Vitter's letter came in response to a request from five Louisiana GOP representatives that was sent to Vitter and Sen. Mary Landrieu.

Sens. Mike Lee, R-Utah, and Ted Cruz, R-Texas, wrote to Burwell on May 16 to ask her questions about the implementation of the Patient Protection and Affordable Care Act, including queries about, among other topics, enrollments, abortion coverage in exchange plans, and the Obama administration's decision to delay the employer mandate while it "has refused to provide the same relief to hardworking Americans through a delay in the individual mandate."

Burwell was confirmed for the OMB spot by a 96-0 vote in April 2013.

NCHC Launches Campaign to Promote Affordable Drug Prices

The National Coalition on Health Care (NCHC) on May 28 launched an effort to promote affordable prices for pharmaceuticals.

The Campaign for Sustainable Rx Pricing "aims to spark a national dialogue about the need to find market-based solutions to the problems caused by the onslaught of new high-priced prescription medicines."

In announcing the project, organizers pointed, in particular, to Sovaldi, a Gilead Pharmaceuticals drug that cures patients of hepatitis C at a cost of $84,000 for a 12-week treatment.

"Sovaldi is the canary in the coalmine, alerting all of us that disaster is coming unless something is done to prevent it," NCHC President and CEO John Rother said. "Unfortunately, the problem is far bigger than one drug - we are talking about a tsunami of expensive medicines that could literally bankrupt the health care system."

NCHC stated that the issue of high-cost drugs "is only going to become more critical to deal with in the coming years," with spending on specialty drugs projected to more than quadruple to $400 billion by 2020.

CalPERS is a member of NCHC.

SEC to Issue Rule on Energy Company Payment Disclosures by March 2015

The Securities and Exchange Commission (SEC) plans to complete a rule requiring oil and gas companies to disclose payments to foreign governments by March 2015.

Section 1504 of the 2010 Dodd-Frank Act directed the implementation of the rule in order 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 nations.

The SEC approved a rule in August 2012 that would have implemented the disclosure requirement, but in July 2013, a federal judge struck the regulation down in a case brought by the American Petroleum Institute (API), the U.S. Chamber of Commerce, the National Foreign Trade Council and the Independent Petroleum Association of America. The commission's analysis of the rule's potential impact, the judge concluded, "was arbitrary and capricious and independently invalidates the Rule."

Producing a new version of the rule had not been included in the SEC's original list of priorities for the coming year, but the commission added it in a recently released update.

Energy companies, though initially active in opposing the rule, now appear to be grudgingly accepting of the regulation while they seek international consistency and regulations that require disclosures of only aggregate numbers, not project-level data.

The European Union (EU) is developing a similar rule, and the United Kingdom is on track to be the first EU nation to implement it, possibly as early as October. Royal Dutch Shell and Exxon Mobil wrote to the SEC on May 1 to ask the commission to make development of the U.S. rule a priority this year in the hope that the U.K. would postpone its implementation until 2015, so that it could take the SEC approach into account. This, the companies, wrote, would be "especially important for purposes of 'equivalency' between the EU and U.S. reporting regimes."

Critics, however, say that energy companies are less interested in equivalency than in "playing both sides off against each other" in order to weaken and slow implementation of any rule.

"A couple of years ago, there was very much a consistent standard on the table, you had the original SEC rule and you had the EU Accounting Directive, which were broadly consistent," said Colin Tinto of Global Witness, an organization that supports disclosures of payments in an attempt to address the "resource curse" that they argue has left many residents of oil and gas-rich nations in poverty. "The API successfully litigated against that and managed to get the SEC rule struck down so it did actually destroy a consistent reporting standard."

Sen. Barbara Boxer, D-Calif., signed on to a May 1 letter from 13 senators to SEC Chairman Mary Jo White urging the commission to "prioritize the issuance of a new rule for Section 1504 by 2015."

"Prompt enactment of a robust rule will help protect U.S. investors, promote U.S. national and energy security, and create more stable operating environments for American businesses," the lawmakers wrote.

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."

Court Rejects Request to Delay Conflict Minerals Rule Deadline

A federal appeals court on May 14 rejected a request to delay an upcoming filing deadline for the Securities and Exchange Commission's (SEC) conflict minerals rule.

The 2010 Dodd-Frank Act directed that the SEC issue rules requiring certain companies to disclose their use of tantalum, tin, gold and tungsten that originated in the Democratic Republic of Congo (DRC) or an adjoining country. The mandate was an attempt to address human rights violations in the region and the use of mineral sales to finance armed conflicts.

The SEC in August 2012 adopted a rule implementing the disclosure requirement. On April 14, the U.S. Court of Appeals for the District of Columbia, in a case originally brought by the U.S. Chamber of Commerce, the Business Roundtable and the National Association of Manufacturers, struck down part of the rule, concluding that requiring

companies to identify their products as "DRC conflict free" or not would violate their First Amendment rights to free speech. The judges, who remanded the case to a lower court, upheld other parts of the rule, though, including filing requirements.
Following the ruling, the SEC issued an order that stays the effective date of the public declaration part of the rule until all appeals in the case have been completed, but still requires affected companies to submit the required filings for the rule, which is to go into effect on June 2.

The three original plaintiffs filed an emergency request asking the same court to put the entire rule on hold until all judicial proceedings have been completed, arguing that they and their members "will suffer irreparable injury in the form of extraordinary and unrecoverable expenditures as well as unresolvable legal uncertainty about the rule's requirements by being compelled to comply with the rule prior to action by the district court on remand," but the court denied the request without commentary.

RELATED NATIONAL AND INDUSTRY NEWS

Public Pensions 3.72 Percent of State and Local Spending: NASRA

Public pensions accounted for 3.72 percent of state and local government spending in 2011, according to an issue brief released by the National Association of State Retirement Administrators (NASRA).

NASRA noted that there are significant variations among cities and states that result from "differences in benefit levels and variations in the size of unfunded pension liabilities." In addition, the group noted, "Pension benefits - and costs - for those who do not participate in Social Security are usually higher than for those who do participate, in order to compensate for the absence of Social Security benefits."

New Jersey had the lowest percentage of combined state and local expenditures on pensions in 2011, with 1.39 percent, while Nevada had the highest at 8.69 percent. California came in at 5.27 percent.

The national average generally declined from just over 5 percent in 1982 to about half that in 2002 before climbing back up over the next decade.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

California Lawmaker Requests Climate Change Hearing Two More Times

A California lawmaker made two attempts in as many weeks in early May to try to get a hearing held on climate change issues.

House Energy and Commerce Committee Ranking Democrat Henry Waxman of California and 23 Democratic colleagues wrote Committee Chairman Fred Upton, R-Mich., on May 8 to ask that hearings be held on the recently released National Climate

Assessment, which stated that, "Many independent lines of evidence demonstrate that the world is warming and that human activity is the primary cause."

"We have different views about what policies are appropriate to respond to climate change," the lawmakers wrote. "But we share the view that we should be listening to the best scientists and making informed decisions. The Energy and Commerce Committee, which is the committee with jurisdiction over the nation's energy laws, has a special obligation to hold these hearings."

Waxman also joined with the ranking Democrat on the panel's Energy and Power Subcommittee, Rep. Bobby Rush of Illinois, in sending a May 1 letter to Upton and subcommittee Chairman Ed Whitfield, R-Ky., to ask that a hearing be held "with the world's leading climate scientists about the findings of [recent Intergovernmental Panel on Climate Change] reports."

The Energy and Power Subcommittee held a hearing on September 18 to examine the Climate Action Plan that President Obama unveiled in June. Before that, Waxman and Rush had submitted written requests for a hearing on climate change issues 26 times in a little more than two years, but no hearings were held.