Pension & Health Benefits Committee

California Public Employees' Retirement System

Agenda Item 6

April 14, 2015

ITEM NAME: 2015-16 Federal Retirement Policy Agenda

PROGRAM: Federal Policy

ITEM TYPE: Action

RECOMMENDATION

Staff recommends that the Pension & Health Benefits Committee (PHBC) approve the California Public Employees' Retirement System (CalPERS) proposed 2015-16 Federal Retirement Policy Priorities, as identified.

EXECUTIVE SUMMARY

The CalPERS Board of Administration (Board) sets the policy direction for the Retirement Benefits Program, including taking positions on state and federal retirement security issues that impact CalPERS members and the CalPERS Trust. In addition, for very high priority areas, the Board may determine that active advancement and engagement on specific topics is warranted. In those cases, CalPERS staff and our Federal Representatives will develop a strategy to advocate for the specific priorities. For 2015-16, staff recommends that the Board adopt the following Priorities for its Federal Retirement Policy program:

- Protecting Public Employee Defined Benefit Plans
- Advancing Retirement Savings and Retirement Security
- Defining Governmental Plans

STRATEGIC PLAN

This agenda item supports Goal C of the 2012-17 Strategic Plan by focusing staff and our the Federal Representatives in national policy development to enhance the long-term sustainability and effectiveness of our programs.

BACKGROUND

Historically, CalPERS has worked in coordination with its Federal Representative to identify and select areas of engagement, discuss them with PHBC, and seek the full Board's support and approval.

The CalPERS Federal Retirement Policy Representatives, the Lussier Group and Williams and Jensen (a joint venture), have worked with staff to draft the proposed 2015-16 Federal Retirement Policy Priorities for the Board's consideration. These Priorities will help CalPERS to establish and strengthen its reputation and relationships on the Hill, and protect its members and stakeholders.

Staff and Board will work in coordination with our Retirement Policy Federal Representatives to meet with key Members of Congress, their staff, and officials in the Administration to provide information on the value of public pension plans, our Pension Beliefs, and other vital information. Meeting with California Congressional Delegation members, and leaders of relevant committees from both chambers and from both sides of the aisle will take the highest priority. Messages will be carefully constructed to ensure consistency with our Pension Beliefs and Policy Guidelines.

Protecting Defined Benefit Plans

Public employee defined benefit programs have been under attack for a number of years and for a number of reasons – some driven by ideology and others by financial concerns exacerbated by the losses sustained during the Great Recession. These attacks have come from conservative think-tanks, academics, and in some instances from public officials concerned about increasing contribution rates. While state and local officials, plan trustees, and public employees and retirees have worked together to enact pension legislation to preserve and strengthen defined benefit plans in many states, others have successfully achieved 'reforms' that undermine the long-term retirement security for public workers.

Members of Congress and congressional staff are not immune to the repeated attacks on the sustainability of public plans and have increased their awareness of calls for alternative plan designs that transfer long-term risks from plan sponsors to individual public employees. In addition, some have questioned the accounting, actuarial, and financial reporting standards that are appropriately unique in the public sector. Others have suggested state and local governments could require federal bailouts due in large part to their pension obligations.

We have seen a steady increase in congressional activity relative to the governance, benefits structures, and financing of public pension plans.

As a leader, CalPERS should educate Congress, the Administration, and other national opinion leaders about Defined Benefit plans and the value they provide not just to public sector employees, but to the general economy. It is critical for CalPERS to share its perspective and priorities regarding specific proposed legislation and the potential impacts of that legislation.

Some possible opportunities would include the following:

- **The Secure Annuities for Employee Retirement (SAFE) Act (113th Congress)**
  The SAFE Act would allow states and municipalities to prospectively replace their defined benefit public pensions by purchasing private insurance annuities for public employees.

  Claiming that unfunded pension liabilities of state and local governments are undermining the fiscal health of states and municipalities, Senator Hatch proposed a new state-regulated, privatized, fixed annuity product for public employees. The group annuity contracts would be bid out every year. So theoretically, a public employee could have a different annuity insurance company for each and every year he or she worked for the state or local government. At the end of his or her career, the individual yearly annuity contracts would be aggregated to provide retirement income. The annuity premiums would be paid by the employer only.

Senator Hatch's expressed intention is to replace defined benefit programs – which he has called incompatible with the public sector – with annuities that eliminate long-term public liabilities. Once a state or local government accepts the SAFE Act, they would be obligated to close their current defined benefit plan to future employees.

Although Senator Hatch hasn't reintroduced the SAFE Act yet, it remains a top priority and will inevitably be discussed as part of the Senate Finance Committee's working group on tax reform. It is vital that CalPERS be visible in the discussion of this issue, to represent the voice of defined benefit plans, and to ensure that California's public sector employees and their retirement funds are protected.

- **The Public Employee Pension Transparency (PEPTA) Act (113th Congress)**
  The PEPTA Act would impose a federal reporting requirement on the funding status of state and local pension plans. While this legislation has not yet been introduced in the 114th Congress, reintroduction is possible. Fulfilling the reporting requirement would be the responsibility of the plan sponsor, i.e., the state or municipal government. Failure to comply with the reporting requirement would result in the loss of the plan sponsor's ability to issue bonds that are exempt from federal tax. Reporting would be required using two distinct methods. First, pension liabilities would be reported based on the economic assumptions and rates of return that each plan currently uses as its expected (long-term) return. Second, all plans that are not fully funded would be required to report their pension liabilities on a rate of return based on a U.S. Treasury obligation yield curve. The Treasury obligation yield curve method would result in outcomes that would show a dramatically lower funded status for public plans. CalPERS opposed PEPTA in both the 112th and 113th Congress.

- **Mandatory Social Security**
  The idea of mandatory Social Security coverage for state and local public employees surfaces from time to time from a variety of academic and think-tank organizations. Recently, those who advocate for the elimination of public sector defined benefit programs have offered mandatory Social Security as an alternative. Although there isn't a specific piece of legislation, some Congressional staff members continue to urge opponents of mandatory

coverage to continue to actively educate Members of Congress and key committee staff regarding the consequences of such an unfunded federal mandate on state and local governments.

Opponent of mandatory coverage, including CalPERS, argue the costs associated with Social Security coverage would undermine the affordability and sustainability of existing defined benefit programs and would ultimately result in higher costs for plan sponsors and reduced retirement security for public workers.

Current CalPERS policy priorities include “oppose any Federal legislation that would mandate Social Security coverage for all state and local governmental employees.”

Advancing Retirement Savings and Retirement Security

A new nationwide public opinion poll conducted for the National Institute on Retirement Security finds that an overwhelming majority of Americans - 86 percent - believe that the nation faces a retirement crisis, and almost 75 percent are concerned about their own ability to achieve a secure retirement. The poll also identified strong support for steady and reliable retirement income from a pension and 67 percent indicated that they would be willing to take less in salary increases in exchange for guaranteed income in retirement.

CalPERS Pension Beliefs expressly call for advocacy for retirement security for America’s workers and for the value of defined benefit plans. CalPERS is a respected voice regarding the value of meaningful retirement security to individual workers and to the national economy. It is critical for CalPERS to share its perspective and priorities regarding specific proposed legislation and the potential impacts of that legislation in the context of its Pension Beliefs. Some possible opportunities would include the following:

- **Department of Labor Fiduciary Rule**
  On February 23, 2015, President Obama announced the redrafting of a Department of Labor (DOL) rule requiring investment professionals to adhere to a higher standard when advising retirement plan participants. The DOL proposal would mean those advising holders of 401(k) plan accounts, individual retirement accounts (IRAs) and other self-directed retirement plan accounts must act as fiduciaries. Under a “fiduciary standard,” advisors must recommend investment products that are in their clients’ “best interest” as opposed to products that are deemed to be “suitable” but may reward the advisors more than competing, lower-fee investment funds. According to a report by the White House Council of Economic Advisors, conflicts of interest likely leads, on average, to one percentage point lower annual returns on retirement savings as well as $17 billion of losses every year for working and middle-class families.

The DOL is expected to issue a Notice of Proposed Rulemaking during the second quarter of 2015. In addition to the DOL's forthcoming action, the U.S. Securities and Exchange Commission (SEC) has been weighing its own fiduciary requirements for the brokers it regulates. On February 20, SEC Chairwoman Mary Jo White said she will seek a decision later in 2015 on whether to raise investment advice standards for brokers but declined to provide a timeline for agency action.

CalPERS Pension Beliefs address two principles that inform this discussion – inadequate financial preparation for retirement as a growing national concern and underscore a commitment that fiduciaries must be accountable for their actions and must perform their duties transparently and to the highest ethical standards. Once proposed rules are released CalPERS may want to comment on behalf of its member.

- **Equal Treatment of Public Servants Act**
  Representatives Kevin Brady (R-TX) and Richard Neal (D-MA) have introduced H.R. 711, bipartisan legislation to repeal the Windfall Elimination Provision (WEP) of the Social Security Act. The Equal Treatment of Public Servants Act replaces the arbitrary WEP calculation with a new formula that treats public employees with non-Social Security covered employment who retire after January 1, 2017, like the rest of American workers. Future benefits will be based on each worker's actual Social Security contributions and work history. The sponsors estimate future reductions will be 50 percent less than the current WEP reduction.

  Current retirees will see their Social Security benefits increased by an estimated 32 percent according to the Social Security Actuary's office. That is an average increase of $1,034 a year, which means an additional $20,000 over the lifetime of an average retiree.

  The legislation has been designed to have no impact on the Social Security trust fund. CalPERS' current federal policy priorities include support for "reasonable" WEP reforms.

- **Survivor and Disability Benefits**
  In February, the Senate Finance Committee approved legislation which would provide a specific exclusion from gross income for amounts paid (1) by the U.S. Department of Justice's Bureau of Justice Assistance as a public safety officer survivor or disability benefit, or (2) under a state program that provides monetary compensation for surviving dependents of a public safety officer who has died as the direct and proximate result of a personal injury sustained in the line of duty.

  Similar bi-partisan legislation is pending in the House, H.R. 606, sponsored by Rep. Eric Paulsen (R-MN). The House has not yet taken action on the bill.

Defining Governmental Plans

In November 2011, the Internal Revenue Service (IRS) and the Treasury Department issued an Advance Notice of Proposed Rulemaking (ANPRM) regarding the definition of a "governmental plan" for purposes of Section 414(d) of the Internal Revenue Code. The ANPRM included a draft of anticipated proposed regulations that created a facts and circumstances test for determining whether an entity is eligible to participate in a governmental plan and invited public comment in this regard.

In June 2012, CalPERS submitted comments to the IRS expressing concern with how the existing status of governmental plans may be affected by the proposed rulemaking discussed in the ANPRM. Additionally, we encouraged the IRS to take a flexible approach, establish a streamlined approval process for employers that want to participate in a governmental plan, protect governmental plans from limited instances of non-conformity, grandfather existing entities currently participating in the CalPERS plan, and provide sufficient amount of transition time once final rules are established.

The IRS received over 2000 comments on the ANPRM, many of which concerned charter schools. In response, the IRS and the Treasury Department issued Notice 2015-07 entitled "Relief for Certain Participants in § 414(d) Plans", which provides further information about what positions the IRS is considering regarding charter schools under the regulations, and transition relief prior to the effective date of the final regulation. Specifically, Notice 2015-07 provides that the IRS and Treasury Department are considering proposing regulations under Section 414(d) specifying that a state or local retirement system that covers employees of a public charter school will not fail to be a governmental plan merely because the system permits employees of a charter school that satisfies the requirements contained in the Notice to participate in the system. Comments on the Notice are due on May 11, 2015.

On behalf of our System, its participating employers, and its members, CalPERS will continue to engage in the public comment process and remains willing to work with the IRS and the Treasury Department as the rulemaking process moves forward.

BUDGET AND FISCAL IMPACTS

Not Applicable

BENEFITS/RISKS

- The benefit of adopting the 2015-16 Federal Retirement Policy Priorities is that it reinforces the Board's commitment to taking proactive positions to educate and/or influence the policy discussions or legislative proposals having a direct impact on the CalPERS Retirement Benefits Program.
- There are no known risks associated with enacting these recommendations.

ATTACHMENTS

Attachment 1 – Pension Beliefs

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