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CalPERS Retirement Policy Update – July 2015

PROTECTING PUBLIC SECTOR DEFINED BENEFIT PLANS

I. **Actuarial Standards Board Hearing:** As the standards-setting body for actuaries in the United States, the Actuarial Standards Board (ASB) is charged with establishing and improving guidance for credentialed actuaries practicing in the U.S., and in July 2014 the ASB issued a Request for Comments (RFC) on ASOPs and Public Pension Plan Funding and Accounting. On July 9, the Actuarial Standards Board (ASB) held a public hearing in Washington, D.C. on issues related to public pension plans.

There were over 10 witnesses, ranging from the Texas State Pension Review Board to well-known consulting actuarial firms. The issues discussed focused on contribution/cost allocation procedures, amortization methods, assumptions, and alternative liability measures. There was also an appearance by the National Public Pension Coalition, which provided a more political message. In essence, most state and local governmental pension problems are caused by a failure to adequately fund the plans and not from bad advice from actuaries. Reinforcing this point, a later witness said that, "no politician ever ran for office saying that they will increase contributions to pension plans. There are always much more popular things on which to spend money."

CalPERS Implications and Next Steps:

Since the CalPERS actuarial staff would be bound by any new actuarial standards, the implications relative to this review process are potentially significant. CalPERS Chief Actuary Alan Milligan is a member of the ASB's Pension Practice Council, therefore CalPERS is particularly close to the ongoing deliberations. CalPERS retirement consultants will communicate with Mr. Milligan, will continue to monitor relevant activity regarding any new standards, and will advise CalPERS of any relevant engagement opportunities that might be external to the ASB process.

II. **CalPERS Communicates Support for H.R. 711; Requests California Co-Sponsors:** On July 25th CalPERS circulated a letter to members of the California Congressional Delegation communicating support for H.R. 711, "The Equal Treatment of Public Servants Act of 2015" and requested them to consider adding their names to the growing list of co-sponsors. The letter resulted from meetings CalPERS representatives had with Congressmen Kevin Brady (R-TX) and Richard Neal (D-MA) in June.

CalPERS Implications and Next Steps:

Passage of H.R. 711 would offer relief to the thousands of CalPERS members who have been adversely impacted by the Windfall Elimination Provision (WEP) of the Social Security Act. Since CalPERS has endorsed the legislation, it's important to help build support for its consideration. House Leadership has indicated that significant bipartisan co-sponsorship would serve as a key indicator of the viability of the legislation. CalPERS retirement consultants will continue to communicate with California congressional offices and will work with other interested organizations to advance H.R. 711.

III. **Senate Finance Savings and Investment Working Group Submits Report:** On July 8, the Senate Finance Committee's Savings and Investment Tax Working Group submitted its report to Chairman Orrin Hatch (R-UT) and Ranking Member Ron Wyden (D-OR). The report was entirely devoted to private sector pension issues. The recommendations were focused on (1) increasing access to retirement plans, (2) increasing participation and contribution levels, and (3) preserving savings and making them last through retirement.

The report states that the recommendations relate only to areas of general consensus, which means that consensus was not reached on issues related to public sector pension plans.

CalPERS Implications and Next Steps:

It's important the report only highlighted private sector pension recommendations. Assuming the Committee attempts to advance legislation during this Congress, it's most likely they would limit themselves to consensus items similar to those recommended by the working group.

However, it's clear from the report that other more controversial pension issues – likely including issues relative to public pension plans – were considered. As a result, it's in CalPERS interest to continue to monitor the work of the Senate Finance Committee. And, since any retirement or tax reform package could provide a vehicle for Chairman Hatch to advance a revised SAFE Retirement Act (annuity accumulation plan), CalPERS, together with a broad range of public sector allies, should continue to educate members and staff regarding concerns with the proposed retirement option.

IV. **New Round of Reports Challenge Future of Defined Benefit Plans:** During July we saw a new series of reports challenging the long-term sustainability of defined benefit pension plans.

- On July 7, *TeacherPensions.org* released a report, stating that, "now is the worst time in at least three decades to become a teacher." The report based this assertion in large part on the pension reforms that have been enacted in the last several years. The report is entitled, "Eating Their Young: How Cuts to State Pension Plans Fall on New Workers." The main point of the report is that the pension reforms typically impact only new hires, which results in a major difference in retirement plans – consequently, retirement security – depending on when you were hired. The proposed solution is to "…fully fund the promises they've already made, while also balancing the needs of the present and future teaching workforce and providing sustainable benefits for all teachers."

  It is important to note that the website, *TeacherPensions.org*, is funded in part by a $748,000 grant from the Laura and John Arnold Foundation (LAJA) to Bellwether Education Partners, Inc. LAJA has been a leading proponent of shifting from the traditional defined benefit pension model to defined contribution plans.

- Continuing the trend in the private sector, a recent survey by Mercer LLP found that 38 percent of financial executives anticipate that their company's defined benefit retirement plans will terminate in the next five years. Eighty-one percent of executives surveyed said they are now considering implementing some form of dynamic de-risking strategy but only 42 percent have such strategy in place.

- On July 14, The Pew Charitable Trusts released a report focused on the most recent comprehensive data on funding for state-run pension systems. The Pew report concludes that pension debt is expected to remain over $900 billion for state plans and that debt will increase to more than $1 trillion when combined with shortfalls in local pension systems. Pew acknowledges in the report that its work on public-sector retirement systems is conducted in partnership with the Laura and John Arnold Foundation.

CalPERS Implications and Next Steps:

As the Nation's largest public employee retirement system and a strong advocate for defined benefit pension benefits, it's important to note that each of these reports adds fuel to the anti-DB agenda in Washington and throughout the country. CalPERS should continue to work with a broad range of public sector allies to educate Members of Congress and congressional staff regarding the benefits of DB pension benefits. CalPERS retirement consultants will continue to engage with industry allies and with relevant congressional contacts to put these and other reports in their appropriate context and to advance strong arguments in support of DP pension plans.

V. **IRS Limits Use of Lump Sum Payments From Defined Benefit Plans:** The IRS and Treasury Department announced their intention to amend minimum distribution regulations under section 401(a)(9) to limit the use of lump-sum payments to replace annuity payments being paid by a qualified defined benefit pension plan. The future amendment to the regulations will apply as of July 9, 2015, with some exceptions.

VI. **IRS Releases Revisions to Employee Plans Determination Letter Program:** In Announcement 2015-19, the IRS eliminated the staggered 5-year determination letter remedial amendment cycles for individually designed plans and will limit the scope of the determination letter program for individually designed plans to initial plan qualification and qualification upon termination. These changes are intended to allow the IRS to more efficiently use its limited resources. It is requesting comments on the implementation of these changes.

Advancing Retirement Savings and Retirement Security

I. **2015 White House Conference on Aging:** On July 13, the White House hosted the 2015 White House Conference on Aging to discuss the challenges facing America's aging population. It included panels that discussed caregiving, retirement security, intergenerational connections, elder justice, and technology.

The panel on retirement financial security was moderated by U.S. Labor Secretary Tom Perez. Several panelists noted many people find it difficult to focus on saving for the distant future and retirement. All panelists agreed there must be more guidance available to both seniors and young workers to understand how to set up retirement accounts and the best way to use the funds. A full report of the Conference is attached.

Four Democrat Senators and 68 House Democrats sent a letter to the White House calling for an expansion of Social Security. "As employers continue moving from a defined benefit model to a defined contribution model of retirement savings, it is critical that we fight to protect and expand Social Security — the only guaranteed source of income in retirement."

Nineteen national organizations (including the AFL-CIO and Pension Rights Center) have also signed a petition to expand Social Security.

President Obama announced that he has directed the Labor Department to issue a rule that would clarify the path forward for state-based retirement savings initiatives. The regulation that the Department will propose by the end of 2015 will clarify how states can move forward with state-sponsored retirement savings programs, including the California Secure Choice Retirement Program.

CalPERS Implications and Next Steps:

As a national leader in the retirement security arena, it's in CalPERS interest to monitor activities that may result for the White House Conference, especially those which will impact the California Secure Choice Retirement Savings program. In that regard, DOL is expected to release rules later this year establishing a road map for states to navigate around ERISA in setting up retirement savings programs for private sector workers.

CalPERS retirement consultants will continue to monitor relevant activity regarding the proposed rule and will advise CalPERS of future engagement opportunities.

II. **Debate Over DOL Fiduciary Rule Continues:** During the month of July we saw a continuing escalation in the debate regarding the proposed DOL Fiduciary Rule, including:

- Department of Labor (DOL) Secretary Thomas E. Perez stated the DOL is already "sharpening" its proposed fiduciary rule and intends to have the rule finalized by the end of President Obama's term. He called retirement one of the "five pillars" of economic security and strengthening it will require commonsense regulations.

- On July 16, the Securities Exchange Commission's (SEC) Investor Advisory Committee held a meeting in which a panel of representatives from the DOL, industry and consumer advocacy groups discussed the proposed fiduciary rule and its impact on potential future SEC rulemakings. Barbara Roper (Consumer Federation of America) explained that this committee previously adopted a recommendation urging the SEC to engage in rulemaking imposing a fiduciary duty on broker-dealers when giving investment advice. She noted Chair White has voiced her support for such a rulemaking. Roper observed that DOL is "much farther along" in its efforts to impose a fiduciary duty under Employee Retirement Income Security Act (ERISA).

- On July 21, the Senate Health, Education, Labor and Pension Committee's Employment and Workplace Safety Subcommittee held a hearing entitled "Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees." The hearing examined DOL's proposed rule defining who is a "fiduciary" of an employee benefit plan under ERISA. The topics discussed included: (1) remedies for consumers; (2) commission and fees; (3) industry feedback on the proposed rule; (4) DOL authority; (5) education versus advice; (6) proprietary products; and (7) cost benefit analysis of the proposed rule; (8) the quality of conflicted advice, and (9) fees.

- On July 22, CalPERS filed a letter with DOL in response to their request for comments regarding the proposed Fiduciary Rule. The letter indicated CalPERS support for efforts to update the employee benefit plan definition of "fiduciary" under ERISA. "CalPERS believes that fiduciaries should be accountable for their actions, and must transparently perform their duties to the highest ethical standards. The Proposed Rule appears to align with CalPERS beliefs on fiduciary responsibilities and we support the Department's efforts to "safeguard plan participants by imposing trust law standards of care and individual loyalty on plan fiduciaries, and by holding fiduciaries accountable when they breach those obligations.""

- The comment period for the Proposed Conflict of Interest Rule defining "Fiduciary" under ERISA has closed. Comments on the proposed rule and accompanying exemptions can be viewed on the Employee Benefits Security Administration's website. A public hearing will be held in August

CalPERS Implications and Next Steps:

As a national leader in the retirement security arena, CalPERS is committed to the highest standards of fiduciary duty and believes that all fiduciaries should be accountable for their actions and must perform their duties transparently and to the highest ethical standards. CalPERS retirement consultants will continue to monitor relevant activity regarding the proposed rule and will advise CalPERS of future leadership opportunities.