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Federal Retirement Policy Report for CalPERS Board
August and September 2015

I. DEVELOPMENTS IN PROTECTING PUBLIC SECTOR DEFINED BENEFIT PLANS

1. **New Jersey State Senate President Asks for Federal Loan Program –** Calling unfunded state and local government pension liabilities a “national crisis,” the President of the New Jersey State Senate, Steve Sweeney (D), is urging the Congress to create a “Federal pension debt restructuring program”—estimated to be as large as $1 trillion—that would “reduce annual payments and provide long-term savings for states throughout the country, including New Jersey.”

   New Developments Since Last Report:

   Although several Members of Congress and others have suggested a federal bailout would ultimately be necessary, no public official has suggested such a plan prior to Senator Sweeney. Public plans have consistently said that no state or local government plan requires or is seeking federal financial assistance.

   CalPERS Implications and Next Steps:

   Since Senator Sweeney’s proposal will be used as validation of the ‘crisis’ that exists in the minds of most anti-defined benefit advocates, the implications for CalPERS and all other public plans is noteworthy and could serve as the subject for future congressional hearings. As appropriate, CalPERS should continue to communicate its view that federal intervention is neither necessary nor warranted.

   CalPERS retirement policy consultants will continue to communicate with relevant congressional staff and industry advocates to monitor any related activity, including any action related to the development of pension legislation in the Senate that could include Sen. Hatch’s annuity accumulation plan, and will advise CalPERS of any appropriate engagement opportunities.

2. **H.R. 711 – The Equal Treatment of Public Servants Act of 2015 –** 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.

   New Developments Since Last Report:

   In a very significant development, Social Security Subcommittee Chairman Sam Johnson (R-TX) joined as a co-sponsor as did Congressmen John Garamendi and Juan Vargas of California. The legislation now has 41 co-sponsors (23 Republicans and 18 Democrats).

   CalPERS Implications and Next Steps:

   Since CalPERS has endorsed the legislation, it’s important to continue to build support for its consideration.

CalPERS retirement policy consultants continue to communicate with California congressional offices and other interested organizations to advance H.R. 711. With the congressional recess behind us, the goal is to secure additional California co-sponsors.

3. **Brookings Report Supports Mandatory Social Security –** Proposals to mandate Social Security on newly hired state and local government employees have surfaced from time to time for decades. Such a mandate would represent a massive unfunded federal mandate on state and local governments and would threaten the sustainability of current state and local pension benefits.

   New Developments Since Last Report:

   On August 11th, the Brookings Institution released a new paper supporting mandatory Social Security for state and local government employees. Unlike past reports on the subject, this paper links the need for mandatory coverage to the funding status of public pension plans. The principal goal of the paper is to argue that, since many state and local pension plans are facing "significant underfunding of promised pension benefits," Social Security is necessary to protect the retirement security of vulnerable public employees.

   CalPERS Implications and Next Steps:

   Given the focus of this new paper, the implications are twofold – (1) the potential threat mandatory coverage would pose to CalPERS funding and plan design; and (2) the ongoing reinforcement of the message that something needs to be done to address the 'significant underfunding' of state and local pension plans. In this regard, it's important to note the paper was financed by the Laura and John Arnold Foundation.

   CalPERS has historically opposed any federal legislation that would mandate Social Security coverage for all state and local government employees and is a founding member of the Coalition to Preserve Retirement Security (CPRS), a national coalition opposed to efforts to force public employers and their workers to participate in the Social Security program. CPRS members include major public employee retirement systems and national, state and local employee, employer and retiree organizations.

   CalPERS retirement policy consultants – separately and in conjunction with CPRS allies – will continue to communicate with relevant congressional staff and industry advocates to monitor any related activity and will advise CalPERS of any appropriate engagement opportunities. In addition, consultants will participate in a Brookings event on October 7th at which this report will be presented.

II. Developments in Advancing Retirement Savings and Retirement Security

I. **Fiduciary Rule –** The Department of Labor has proposed a rule that would impose a fiduciary standard on financial firms and advisers providing retirement advice.

   New Developments Since Last Report:

   Consideration of the proposed rule continues to be the subject of considerable debate.

   - Democratic Senators have written to Secretary of Labor Tom Perez expressing concerns about the unintended consequences of the rule as drafted.
   - DOL held four days of hearings (Aug 10-13) on the proposed rule and subsequently opened a new comment period.
   - On September 10th, two subcommittees of the House Financial Services Committee (HFSC) held a joint hearing entitled 'Preserving Retirement Security and Investment Choices for All Americans." In addition

to discussing the proposed rule, the hearing examined H.R. 1090, the Retail Investor Protection Act, which would prevent DOL from creating any rule expanding the ERISA definition of fiduciary until after the SEC issues a final rule creating a uniform fiduciary standard for brokers and dealers. Following the hearing, HFSC Chairman Jeb Hensarling (R-TX) expressed support for H.R. 1090, stating the Committee would advance the bill to "provide Americans with more choices and greater freedom to save for their future."

- On September 18th, the House Financial Security and Life Insurance Caucus held a briefing to discuss the impact the proposed fiduciary rule would have on savers, retirees and small business. Bipartisan concerns were expressed regarding the proposed rule's impact on insurance products that are important for retirement security.

CalPERS Implications and Next Steps:

Given CalPERS Pension Beliefs (i.e. inadequate financial preparation for retirement as a growing national concern and a commitment that fiduciaries must be accountable for their actions and perform their duties transparently and to the highest ethical standards), on July 16th CalPERS submitted a letter of support for the proposed rule. The Obama Administration and other interested groups have expressed appreciation for CalPERS leadership.

CalPERS retirement policy consultants will continue to monitor any related activity and will advise CalPERS of any appropriate engagement opportunities. In addition, consultants have communicated with the CalPERS Retirement Research and Planning Division regarding next steps.

II. **State-Based Retirement Programs –** The Department of Labor is developing a rule that would help facilitate the creation of state-based retirement plans such as the California Secure Choice plan.

New Developments Since Last Report:

- In recent interviews, Phyllis Borzi, Assistant Secretary for DOL's Employee Benefits Security Administration, provided significant insight into DOL's upcoming regulatory initiative on state-based plans.
- Borzi pointed out that states are embarking on one of two paths: (1) Avoid ERISA regulation, which is characterized by the California effort; or (2) Embrace ERISA and offer a simplified ERISA-based plan, which is characterized by Massachusetts and Washington.
- Regarding the first approach, DOL is looking at proposing a regulation to build on a payroll deduction IRA model. The second approach would be addressed by what Borzi called "sub-regulatory guidance," the form of which (FAQs, for example) is not known at this time. This would involve providing an ERISA framework to assist states as they move forward with legislative proposals. DOL has been quick to point out, however, that the courts are the arbiter of whether a particular state law is preempted by ERISA.
- DOL anticipates releasing both pieces of guidance simultaneously. The goal for release is the end of the calendar year.

CalPERS Implications and Next Steps:

As a national and state leader in the retirement security arena, CalPERS has a tangential interest in the DOL rulemaking process and a more specific interest in how such a rule would impact retirement security in California. However, to date, CalPERS has not expressed an interest to engage with DOL on the proposed rule.

CalPERS retirement policy consultants will continue to monitor any related activity and will consult with CalPERS staff once a proposed rule is released.

III. Other Updates and Information

1. **Study Concludes Defined Contribution Plans are Cost-Effective –** A study by the Manhattan Institute for Policy Research, which has been a consistent critic of defined benefit (DB) pension plans for state and local government employees, concluded that defined contribution (DC) plans achieve similar investment returns as DB plans and are a good option for providing retirement security.
   According to the National Institute on Retirement Security (NIRS), the new Manhattan Institute study authored by Josh McGee is "so fundamentally flawed that it is irrelevant to the retirement security debate." McGee is a senior fellow at the Manhattan Institute and vice president of public accountability at the Laura and John Arnold Foundation. His study, entitled "Defined-Contribution Pensions Are Cost-Effective," was released the week of August 10, 2015.

   As NIRS points out, the McGee study, while asserting that it assesses public sector retirement plans, uses private sector pension data that is not comparable. NIRS insists, therefore, that this "invalidates the findings."

2. **Research Shows Public Defined Benefit Plans Effectively Manage Retirement Security Risk** – NIRS released a new brief analyzing what role annuities can play in public pension plans. It identified four security risks for defined benefit (DB) plans: investment, adequacy, longevity, and inflation. Analysis showed most DB plans managed these risks well in different ways. Annuities may help manage longevity risk, but only a small share of individuals use annuities to provide income protection. It found that DB plans are highly cost efficient and it is difficult to generate a given level of monthly income from fixed rate annuities. In addition, compared to DB plans, annuities may offer fewer and reduced consumer protections, which are based in state insurance law.

3. **Treasury Holds Hearing on Multiemployer Pension Plan Rules** - On September 10, the Treasury Department held a public hearing on proposed rules for implementing pension cuts for retirees in severely troubled multiemployer pension plans, as authorized by the Multiemployer Pension Reform Act of 2014. Treasury and the Internal Revenue Service (IRS) in consultation with the Pension Benefit Guaranty Corporation (PBGC) and DOL are charged with developing rules governing any benefit reductions. The witness panel included representatives from all four governmental entities. The panel also heard testimony from concerned retirees and pension experts.