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Federal Retirement Policy Report for CalPERS Board
February 2016

I. DEVELOPMENTS IN PROTECTING PUBLIC SECTOR DEFINED BENEFIT PLANS

1. **S. 2381 – The Puerto Rico Assistance Act –** Sections 202 and 203 of the proposed legislation would advance versions of the Public Employee Pension Transparency Act and the Secure Annuities for Employees (SAFE) Act, both of which have been opposed by CalPERS. In December, CalPERS CEO Anne Stausboll wrote to several key Members of the California Congressional Delegation in opposition to the provisions. In addition, 17 national organizations – including public employee retirement associations and public employer and employee organizations – have written Congressional leaders expressing strong opposition to the public pension requirements contained in S. 2381.

   New Developments Since Last Report:

   - On February 10, Chairman Hatch wrote to Puerto Rico Governor Alejandro Padilla requesting a massive amount of information on the Commonwealth's finances, including requests for data and practices related to the public pension plans in Puerto Rico.

   CalPERS Implications and Next Steps:

   In his letter, Chairman Hatch linked the plight of the pension plans in Puerto Rico to the funding status of plans in the 50 states: "As with Puerto Rico, many State and local public pension plans are critically underfunded…underfunded public pension plans have factored into resolution of a number of recent, large municipal bankruptcies, and it is likely that future municipal bankruptcies will also involve, in one way or another, underfunded pension plans."

   CalPERS retirement policy consultants will continue to monitor any Puerto Rico-related legislation and will continue to work closely with key Congressional staff and with the broad range of public sector advocacy groups to educate Members of Congress and staff regarding the negative impact these provisions could have on public retirement plans, plan members and their families, and on public employers.

2. **Normal Retirement Age –** The Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) issued final regulations defining normal retirement age in 2007; however, in response to objections from state and local governmental plans, the application of this rule has been repeatedly delayed for governmental pension plans. In 2012, the IRS and Treasury issued a notice which described modifications to the 2007 regulation with respect to governmental plans.

   New Developments Since Last Report:

   - On February 19, your federal representatives participated in a special meeting of national groups and top pension lawyers that focused on the U.S. Treasury Department's recently-released, proposed regulations on normal retirement age. In general, the view is that the proposed regulations are responsive to many of the comments made over the years by the plan community. The meeting was held in conjunction with the winter conference of the National Association of Public Pension Attorneys (NAPPA).

CalPERS Implications and Next Steps:

Since CalPERS will be required to comply with this regulation, this rulemaking is very important to CalPERS and to all state and local governmental plans. CalPERS retirement policy consultants have begun a discussion with appropriate staff to develop comments for submission to Treasury and the IRS, and to coordinate with allies in the plan community.

II. Developments in Advancing Retirement Savings and Retirement Security

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

New Developments Since Last Report:

- The DOL officially transmitted its draft final regulations on the fiduciary standard to the Office of Management and Budget (OMB). OMB review is the final step before DOL is able to publish a final rule on the fiduciary standard. While OMB typically takes approximately 90 days to complete its review, it spent just 50 days reviewing the 2015 proposed rule on the fiduciary standard.
- On February 2 and 3, the House Committees on Education and the Workforce and Ways and Means approved legislation intended to supplant the DOL fiduciary rule, H.R. 4293 and H.R. 4294. The bills are essentially the same, but H.R. 4293 would amend ERISA, over which the Committee on Education and the Workforce has jurisdiction, while H.R. 4294 would amend the tax code, over which the Ways and Means Committee has jurisdiction.
- While speaking at the American Bar Association's Employee Benefits Committee, Assistant Labor Secretary Phyllis Borzi stated that the DOL's proposed fiduciary rule will be finalized in the first half of 2016. Borzi emphasized that DOL has carefully considered the nearly 35,000 public comments submitted. CalPERS submitted a comment to the rulemaking.

CalPERS Implications and Next Steps:

CalPERS retirement policy consultants will continue to monitor activity regarding the proposed DOL rule. The next step will be for DOL to issue a final rule. In the meantime, consultants will also monitor these related legislative proposals and will advise CalPERS regarding appropriate engagement.

2. **President's FY 2017 Budget –** The President's FY 2017 budget includes a number of retirement proposals.

New Developments Since Last Report:

On February 9, President Barack Obama released his FY 2017 budget request containing the following retirement security proposals.

- *Automatic enrollment IRAs* – The Administration proposes a program that would require employers that do not currently offer a qualified retirement plan to their employees to provide automatic enrollment in an IRA. Employees could opt-out of the program or adjust the default contribution rate of three percent up or down. Employers with fewer than 10 employees and employers in existence for less than two years would be exempt.
- *Permit unaffiliated employers to maintain a single multiple-employer defined contribution plan (so-called open-MEP)* – The proposal would permit unaffiliated private sector employers to adopt a defined contribution MEP that would be treated as a single plan for purposes of ERISA, provided that the entity promoting and administering the plan, the participating employers, and the plan meet certain conditions designed to provide protections for the employees. The plan provider must be a regulated financial institution that agrees to be a named ERISA fiduciary.

- *Pilot programs for state-run initiatives* – The Administration requests $6.5 million for state-run auto-enrollment IRAs or 401(k) plans.
- *Improve collection of information related to non-covered earnings (Social Security)* – The Administration requests up to $70 million for administrative expenses, of which $50 million would be available to states, to develop a mechanism so that the Social Security Administration (SSA) could better enforce the offsets for the windfall elimination provision (WEP) and government pension offset (GPO). The proposal also states that after 10 years SSA would adjust benefits based on the extent to which workers have non-covered earnings. The description of this change is consistent to the approach taken in House Ways and Means Chairman Kevin Brady's (R-TX) legislation on WEP, H.R. 711, which CalPERS supports.

CalPERS Implications and Next Steps:

The President's proposals have potential implications for CalPERS. Given CalPERS belief that all employees should have effective means to pursue retirement security, the auto-IRA and open-MEP proposals may represent real opportunities to advance the goal of retirement security for non-public workers; additional funding could further incent state-based retirement initiatives; and the proposals to address the Social Security Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO) are consistent with CalPERS policy and may facilitate additional support for Chairman Brady's WEP reform legislation.

Although the President's budget proposal isn't likely to be seriously considered by Congress, action on individual proposals is possible. CalPERS federal representatives will monitor these retirement-related proposals and will recommend CalPERS engagement as appropriate.

3. **State-Based Retirement Programs –** DOL 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:

- A market analysis of the California Secure Choice Program indicates that at least 70 percent of the 6.8 million Californians eligible are willing to participate in the state-sponsored private sector retirement savings program. The analysis recommends moving forward with the Secure Choice Program at a default contribution rate of five percent.
- In his annual State of the City address, Mayor Bill de Blasio proposed that New York City become the first U.S. city to establish a retirement savings program for private-sector employees. The plan would be similar to the Obama Administration's auto-enrollment IRA proposal.
- Iowa State Treasurer Michael Fitzgerald said he will ask the state legislature to approve a bill that would allow his office to set up a plan for private sector workers. The plan would not guarantee a return or be responsible for any losses. The goal is to increase Iowa workers' retirement savings and make it easier for small businesses that may not be able to create their own plans. The plan would be modeled after the successful state-run, college savings plans (commonly referred to as 529 plans after their citation in the Internal Revenue Code) and give the Treasurer's office flexibility so changes can be made easily. Participation would be voluntary, but would use the automatic individual retirement account model. The state would issue a request for proposal for a vendor to provide investment guidance.

CalPERS Implications and Next Steps:

As a national and state leader in the retirement security arena, CalPERS has offered support for the DOL rule. CalPERS retirement policy consultants will continue to monitor any activity regarding the proposed rule and will communicate with CalPERS staff to determine whether additional engagement is appropriate.

III. Other Updates and Information

1. **New School Professor Proposes Alternative Retirement System –** In a February 13 panel presentation at the American Bar Association's Employee Benefits Committee Meeting, Theresa Ghilarducci, Professor of Economics at the New School for Social Research, contended that a fundamentally different retirement system is necessary to address the inadequacies of the 401(k) plan. In her proposal, employers would make mandatory contributions on behalf of their workers to a government-managed retirement system that would pool investments and charge lower fees made possible by economies of scale. The accounts would be portable for employees when they change jobs.

2. **New Jersey Governor's Budget –** Along with Illinois and Kentucky, New Jersey is one of the states that critics of defined benefit (DB) plans most often point to when making the claim that state and local governmental DB plans not sustainable. Consequently, it is important to monitor the pension funding debate situation there. On February 16, New Jersey Governor Chris Christie unveiled a $34.8 billion budget for 2017 that includes a $1.9 billion contribution to the state workers' benefits fund. The $1.9 billion contribution is only 40 percent of the actuarially determined contribution (ADC). The Governor and the Legislature are shielded by a New Jersey Supreme Court decision, which found that a 2011 law providing public workers with a contractual right to contributions could not bind future legislators and governors. The budget address comes one month after the Governor criticized a proposal by Senate President Stephen Sweeney that would have required the state to make payments of 50 percent of the ADC in fiscal year 2018.