THE LUSSIER GROUP, INC.

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Federal Retirement Report for CalPERS Board
May 2016

I. PROTECTING DEFINED BENEFIT PLANS

A. Oppose H.R. 4822 (Nunes)

1. H.R. 4822 – The Public Employee Pension Transparency Act (PEPTA) – would for the first time impose an unfunded federal reporting requirement on the funding of state and local pension plans. According to Rep. Nunes, the bill is designed to "prevent the federal government from bailing out distressed U.S. state and municipal pension funds, and to rectify serious shortcomings in the financial accounting and transparency of these funds." The proposal does not protect benefits, save taxpayer money, or improve retirement plan funding. In addition, since failure to comply with the reporting requirement would result in the loss of the plan sponsor's ability to issue bonds, it threatens to eliminate the tax-exempt bonding authority of state and local governments.

2. Specific changes/developments since last report:

   - New House legislation on Puerto Rico has been introduced – H.R. 5278. The legislation does not contain any new federal reporting requirements on state and local plans' funding status (PEPTA). The only pension-related provision relates to an optional study of materially underfunded pensions in Puerto Rico.
   - H.R. 5278 was approved by the House Natural Resources Committee on May 25th and is likely to see action on the House floor in June. It is unclear at this time what amendments will be offered on the floor.

3. Implications for CalPERS:

   PEPTA would impose new and unprecedented federal reporting requirement on CalPERS and all other public pension plans that would require plan liabilities to be reported in a manner that would overstate the under-funding of plans.

4. CalPERS/Federal Representative Actions:

   - Williams & Jensen and The Lussier Group met with staff in the following offices to discuss PEPTA: Sen. Dianne Feinstein, Majority Leader Kevin McCarthy, Minority Leader Nancy Pelosi, and Reps. Xavier Becerra, Grace Napolitano and Jim Costa. *(Rep. Becerra is a member of the House Democratic Leadership and the Ways and Means Committee. Reps. Napolitano and Costa serve on the Natural Resources Committee, which has jurisdiction over Puerto Rico legislation.)*
   - The primary goal of the meetings was to urge them to resist any attempts to add PEPTA to legislation that is being drafted on Puerto Rico.
   - CalPERS' representatives participated in a meeting of the Public Pension Network, ad hoc group comprised of major public pension-related trade associations, labor unions and other interest groups, such as AARP, to discuss the legislative and regulatory landscape – including PEPTA – and to coordinate messages and Hill activity.

5. Recommendations for Next Steps:

   Although the most recent House legislation doesn't include the full version of PEPTA, we assume that Rep. Nunes and several anti-DB pension advocates will continue their efforts to amend the Puerto Rico legislation to include some version of PEPTA. We also assume that Senator Hatch could continue to pursue these provisions during Senate consideration of Puerto Rico assistance legislation.

   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 prevent the inclusion of unrelated retirement provisions that would threaten the independence of state and local pension plans.

B. Oppose S. 2381 and The SAFE Act (Hatch)

1. The Secure Annuities for Employee (SAFE) Retirement Act – would establish an optional annuity accumulation plan for state and municipal employers and employees. Although purely optional for plan sponsors, the plan has been positioned as an alternative and ultimate replacement for defined benefit pension plans. As a replacement, the annuity accumulation plan has many deficiencies, including a lack of survivor or disability benefits for public safety workers, a prohibition on employee contributions, and no guarantee for annual contributions. Senator Hatch included his annuity accumulation plan in section 203 of his Puerto Rico Assistance Act of 2015.

2. Specific changes/developments since last report:

   No specific action on S. 2381

3. Implications for CalPERS:

   CalPERS has opposed the SAFE Act as an unnecessary alternative to public sector defined benefit retirement plans and as a plan that would fail to protect the retirement security of any participating public employee.

4. CalPERS/Federal Representative Actions:

   CalPERS' federal representatives and other public plan advocates remain concerned that the Puerto Rico legislation could be used as a vehicle to advance some version of Senator Hatch's annuity accumulation plan. As a result, CalPERS concerns regarding the annuity accumulation plan were highlighted in all of the meetings referenced in the previous item.

5. Recommendations for Next Steps:

   In addition to monitoring any Puerto Rico related legislation, representatives will continue to work closely with key Congressional staff and with the broad range of public sector advocacy groups to anticipate and respond to any attempt by Senator Hatch to advance his annuity accumulation plan as either a stand-alone piece of legislation or as an amendment to other Senate legislation.

II. Developments in Advancing Retirement Savings and Retirement Security

A. Support H.R. 711 (Brady-Neal)

1. H.R. 711 – The Equal Treatment of Public Servants Act of 2015 - would repeal the current Windfall Elimination Provision (WEP) of the Social Security Act and replace it with a new formula that will fairly account for covered and uncovered employment throughout an individual's career. The legislation will

provide relief to current retirees whose Social Security benefits have been arbitrarily reduced by the existing WEP formula and, in general, will provide a less significant reduction to future retirees.

2. Specific changes/developments since last report:

   19 co-sponsors have been added to H.R. 711 – including Congressman Jared Huffman from California – during May.

3. Implications for CalPERS:

   The passage of H.R. 711 would offer relief to the thousands of CalPERS members who have been – or will be in the future – impacted by the WEP. Current retirees will see their WEP reduction reduced by up to 50%; on average, future retirees will see a reduction approximately 50% less than current law.

4. CalPERS/Federal Representative Actions:

   - CalPERS support for H.R. 711 was highlighted in all of the congressional meetings referenced in the first item, including Sen. Dianne Feinstein, Majority Leader Kevin McCarthy, Minority Leader Nancy Pelosi, and Reps. Xavier Becerra, Grace Napolitano and Jim Costa.
   - CalPERS' representatives met with House Ways and Means Social Security Majority Staff on multiple occasions to discuss ongoing questions regarding the Social Security Actuary's analysis of H.R. 711, ongoing discussions regarding possible amendments (including possible Government Pension Offset reforms), and legislative strategies to move H.R. 711 before the August recess.

5. Recommendations for Next Steps:

   CalPERS' federal representative will continue to work closely with Congressmen Brady and Neal to advance this legislation during the current Congress. This effort will continue to include outreach to key members of the California Congressional Delegation.

B. State-Run Retirement for Private Sector Employees

1. The Department of Labor (DOL) is developing a rule that would facilitate the creation of state-based retirement plans such as California's Secure Choice plan. The rule is intended to enable states to initiate innovative ideas that will boost overall retirement savings.

2. Specific changes/developments since last report:

   - House lawmakers in Connecticut voted to approve legislation to require private sector employers to participate in a new state individual retirement account program.
     - Employers that made $5,000 or more in the last calendar year and had five or more employees would automatically enroll their workers.
     - The quasi-public Connecticut Retirement Security Authority would be created to establish a program for IRAs for private sector employees who have worked for a qualified employer for at least 120 days and are at least 19 years old. Employees would be able to opt out.
     - The bill is supported by a number of organizations, including the Connecticut AFL-CIO and Connecticut's Legislative Commission on Aging.
   - On May 10, Maryland Governor Larry Hogan signed into law a bill creating a state-run, IRA program for private sector workers who do not have access to a retirement plan at work.
     - Employers that do not offer plans must automatically enroll their employees into payroll-deduction IRAs. The law does not specify the size of the employer required to participate, but excludes all government agencies, those currently offering savings programs, and those that have not been continuously in business during the current and preceding calendar

years. The Maryland Small Business Retirement Savings Board, which is established by the new law, will determine contribution rates.

3. Implications for CalPERS:

   As a national and state leader in the retirement security arena, CalPERS has a general interest in the DOL rulemaking process and more specific interest in how such a rule would impact retirement security in California. CalPERS has offered its support for the rule in prior communication with DOL.

4. CalPERS/Federal Representative Actions:

   CalPERS' federal representatives continue to monitor any activity regarding the proposed rule and related state-based activity that could inform and/or influence the rulemaking process.

5. Recommendations for Next Steps:

   Representatives will communicate with CalPERS staff should any additional engagement be appropriate or necessary.

C. Normal Retirement Age Regulation

1. In January, the Treasury Department and the Internal Revenue Service published long-awaited proposed regulations regarding the "Applicability of Normal Retirement Age Regulations to Governmental Pension Plans." These regulations were originally issued in 2007; however, in response to objections from state and local government plans (including CalPERS), the application of the rule has been repeatedly delayed. In 2012, a notice was issued that described modifications to the 2007 regulation.

2. Specific changes/developments since last report:

   - In the recent round of formal comments on the proposed rules, an issue has arisen over the breadth of the definition of "public safety employee" for purposes of applying the safe harbors in the rule. The proposed rules use the definition found in Internal Revenue Code section 72(t)(10)(B), which relates to the waiver of the early withdrawal tax penalty.
   - In its comments, the AFL-CIO expressed concern that the definition could exclude employees, such as correctional officers or those whose duties include the detention of individuals suspected or convicted of criminal offenses. Similarly, the American Federation of State, County and Municipal Employees (AFSCME) stated that the final regulations should cover all corrections, probation, parole and court officers. Meanwhile, the International Association of Fire Fighters (IAFF) urged the retention of the definition found in the proposed rule because it covers both firefighters and emergency medical personnel, without unintentionally covering groups such as volunteer firefighters.
   - While Treasury-IRS may offer more latitude on this definition when they release the final rule later this year, they have not yet been receptive to suggestions that they go beyond the section 72(t)(10)(B) definition.

3. Implications for CalPERS:

   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.

4. CalPERS/Federal Representative Actions:

   Based on communication with CalPERS staff, a decision was made not to comment further on the proposed regulation. It was understood that industry trade associations to which CalPERS belongs (i.e. NASRA, NCTR, and NCPERS) would submit supportive comments. CalPERS' federal representatives will continue to monitor any activity regarding the proposed rule.

5. Recommendations for Next Steps:

   Representatives will communicate with CalPERS staff should any additional engagement be appropriate or necessary.

III. OTHER UPDATES AND INFORMATION

1. **Multiemployer Pension Plans -** The U.S. Treasury Department rejected a proposal made under a new federal law to significantly reduce pension benefits for private sector workers in the trucking industry. The proposal, which was made by the Central States Pension Fund, was rejected by Kenneth Feinberg, the special master appointed by Treasury. Feinberg said that the proposal did not (1) sufficiently improve the financial health of the pension plan; (2) equitably distribute the benefit cuts; and (3) explain clearly enough the impacts of the cuts to the participants. This has been a closely watched matter for all stakeholders in the pension community. This was the first test case of the new 2014 law. Related legislation includes:

   - ***Keep Our Promises Act (KOPPA) (H.R. 2844, S. 1631) –*** KOPPA would repeal the Multiemployer Pension Reform Act's (MPRA) benefit cutback provisions. The Senate version of the bill was introduced by presidential candidate and Vermont Senator Bernie Sanders; the House version was introduced by Rep. Marcy Kaptur (D-OH).
   - ***The Pension Accountability Act (PAA) (H.R. 4029, S. 2147) –*** PAA would address plan participant voting on any proposed benefit suspensions approved by Treasury. PAA would allow a majority of plan participants and beneficiaries who cast a vote – rather than majority of the total participants and beneficiaries – to reject pension cuts. Sen. Rob Portman (R-OH) and Rep. David Joyce (R-OH) have introduced this legislation.
   - ***Pension Fund Integrity Act of 2016 (S.2894) –*** This bill would cut executive salaries and bar salary increases in instances where retiree benefits are slashed as part of a rescue petition. This bill was introduced by Sen. Debbie Stabenow (D-MI).

2. **Pension Model for Rust Belt Cities -** On May 3, the Manhattan Institute issued a report in which they proposed that the Detroit bankruptcy model, known as the "grand bargain," which relies heavily on private foundation contributions to leverage state government contributions, could be applied to the unfunded retirement liabilities of other rust belt cities, namely Chicago, St. Louis, Cleveland and Buffalo.

   Christopher Berry, director of the Center for Municipal Finance at the University of Chicago's Harris School of Public Policy noted that the Manhattan Institute's proposal is flawed. The grand bargain was intended as a way out of bankruptcy, not as a solution to the public pension problem. The pension component of Detroit's grand bargain included funding from outside sources and cut benefits for participants. The plan will require Detroit to ramp up pension contributions again in 2023, although it's unclear if Detroit will be able to meet those obligations. Berry claimed this level of uncertainty should not be extended to neighboring rust belt cities and called the plan bad public policy.

3. **New Study of Defined Contribution Savings -** On May 5, the Government Accountability Office (GAO) released a report discussing recent trends in defined contribution (DC) plan participation and how much households could potentially save in DC plans over their career. GAO found 40 percent of U.S. households had some retirement savings in a DC plan in 2013 and account balances varied by household

income and race. Approximately 39 percent of working households lacked access to employer-sponsored DC plans at their job. Low-income earners and Black and Hispanic households were even less likely to have access. For example, 25 percent of working low-income households had some savings in a DC plan compared to 81 percent of working, higher-income households. According to GAO's projections, households in the lowest earning group accumulated DC savings that generated lifetime income in retirement of about $560 per month, whereas households in the highest earning group saved enough to receive 11 times more per month in retirement.

4. **Determination Letter Program -** The Internal Revenue Service (IRS) is working on guidance regarding upcoming changes to its determination letter program, according to Roberts Choi, director of employee plans in the Tax Exempt and Government Entities Division. Choi stressed that the program "isn't going away" and that amended retirement plans will still be part of the determination letter program. However, it is not yet clear what would constitute an "amended plan" for this purpose and Choi said this will be determined on an annual basis. The IRS had previously announced that in 2017 the program generally would only accept determination letter applications from sponsors of individually-designed plans for initial plan qualification and upon termination.

5. **Americans Working Past Age 65 -** Almost 20 percent of Americans age 65 and older are now working, according to the latest data from the Department of Labor's Bureau of Labor Statistics. A 2015 study by the Federal Reserve found 27 percent of Americans said they will keep working as long as possible.

6. **Investment Returns of Public Pensions -** U.S. state and municipal pensions saw a median 1.24 percent return in the first quarter as bond market gains could not overcome low U.S. stock returns and losses on international equities, according to the Wilshire Trust Universe Comparison Service. Public pensions with more than $5 billion in assets, which have more funds invested with hedge funds and private-equity, performed slightly worse than others. Large pensions saw a median 1.15 percent for the quarter. Public pensions have an average assumed annual rate of return of approximately 7.7 percent.

7. **DOL Fiduciary Rule –** Congress has now cleared H.J. Res. 88, which would overturn DOL's final rule on the definition of fiduciary. The Congressional Review Act allows Congress to approve resolutions of disapproval by simple majority votes. However, President Obama has already announced that he will veto the resolution. Neither the House nor Senate approved the resolution by a two-thirds vote, so Congress is unlikely to be able to muster the votes necessary to override the veto. Therefore, the final rule is ultimately expected to take effect.