THE LUSSIER GROUP, INC.

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Federal Retirement Report for CalPERS Board

September-October 2016

I. PROTECTING DEFINED BENEFIT PLANS

A. 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." However, 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:

   Coal Miners Benefits Legislation

   - CalPERS' retirement policy consultants have been monitoring any legislation – such as the Miner's Protection Act, S. 1714 – to prevent the inclusion of unrelated retirement provisions – such as H.R. 4822 – that would threaten the independence of state and local pension plans.
   - The Coal Miners Protection Act, S.1714, has been approved by the Senate Finance Committee and is awaiting further action during the lame-duck session. Under the legislation, retirees who lose their healthcare benefits when a mining employer goes bankrupt, would be provided relief. The legislation also contains relief to the pension fund for retired miners.
   - S. 1714 was approved without any amendments related to state and local governmental pension plans, such as PEPTA (H.R. 4822) or the annuity accumulation plan.
   - Likewise, the Finance Committee approved a measure aimed at enhancing 401(k) and IRA retirement plans, the Retirement Enhancement and Savings Act, without any provisions on public plans

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. As a result, any pension-related legislation that advances without the PEPTA provisions is a success for CalPERS.

4. CalPERS/Federal Representative Actions:

   - CalPERS' retirement policy consultants have been working with other public plan advocates to advocate against any efforts to include unrelated provisions – such as H.R. 4822 – to any pension-related legislation.

- Tony Roda (Williams & Jensen) presented the federal legislative update at the annual public safety conference of the National Conference on Public Employee Retirement Systems (NCPERS), including a discussion of the Public Employee Pension Transparency Act (PEPTA), the annuity accumulation plan, the windfall elimination provision and the implementation of the Puerto Rico Oversight Management and Economic Stability Act (PROMESA), as it relates to pensions. Tom Lussier (The Lussier Group) presented a similar federal legislative update at the annual conference of the National Pension Education Association (NPEA).

5. Recommendations for Next Steps:

   The CalPERS' retirement policy consultants will continue to monitor any legislation (such as the pending Miner's Protection Act, S. 1714, and the Retirement Enhancement and Savings Act) to prevent the inclusion of unrelated retirement provisions (such as H.R. 4822) that would threaten the independence of state and local pension plans.

B. S. 2381 – The Puerto Rico Assistance Act (Annuity Accumulation Plan (Hatch))

1. Section 203 of S. 2381 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.

2. Specific changes/developments since last report:

   As noted in Item A, the Senate Finance Committee has approved the Coal Miners Protection Act, S.1714, and the Retirement Enhancement and Savings Act without any amendments related to state and local governmental pension plans, such as the annuity accumulation plan.

3. Implications for CalPERS:

   Since Congress has passed a Puerto Rico assistance package, S. 2381 is effectively moot for this Congress; however, it's possible that Senator Hatch will attempt to attach his proposed annuity accumulation plan) to other relevant pension legislation. CalPERS believes the annuity accumulation plan is an unnecessary alternative to public sector defined benefit retirement plans and would fail to protect the retirement security of any participating public employee.

4. CalPERS/Federal Representative Actions:

   As noted in Item A, CalPERS' retirement policy consultants have been working with other public plan advocates to advocate against any efforts to include unrelated provisions – such as the annuity accumulation plan - to any pension-related legislation.

5. Recommendations for Next Steps:

   The CalPERS' retirement policy consultants will continue to monitor any legislation (such as the pending Miner's Protection Act, S. 1714, and the Retirement Enhancement and Savings Act) to prevent the inclusion of unrelated retirement provisions (such as the annuity accumulation plan) that would threaten the independence of state and local pension plans.

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:

   - Eight Members of Congress, including California Congressman Mark DeSaulnier (D-CA 11), have joined H.R. 711 as co-sponsors. These additions bring the total co-sponsors to 130.

   - On September 8, Sen. Pat Toomey (R-PA) introduced legislation (S.3303) that would exempt firefighters and police officers from the Government Pension Offset and the Windfall Elimination Provision under the Social Security Act.

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 approximately 15 percent for the first 10 years and up to 50 percent thereafter; on average, future retirees will see a reduction approximately 35 percent less than current law. These benefits have been updated based on revised SSA actuarial analysis and proposed amendments to H.R. 711.

4. CalPERS/Federal Representative Actions:

   - On September 12, a CalPERS representative (Tom Lussier of The Lussier Group), met with representatives of the International Association of Fire Fighters (IAFF), the American Federation of State, County and Municipal Employees (AFSCME), and the American Federation of Teachers (AFT) to discuss strategies to advance the legislation before the end of the current Congress. In addition, a meeting was held with the Minority Staff Director of the Ways & Means Social Security Subcommittee to discuss options to improve H.R. 711.
   - On October 6, Tom Lussier (The Lussier Group), met with the Majority Staff Director of the Ways & Means Social Security Subcommittee to discuss outreach to other public sector organizations, efforts to secure additional actuarial data, and options to amend H.R. 711.
   - As noted in Item A, CalPERS representatives (Tony Roda and Tom Lussier) have discussed H.R. 711 in presentations to the NCPERS public safety conference and the NPEA annual conference. These efforts are designed to correct misinformation and to encourage support for H.R. 711.

5. Recommendations for Next Steps:

   CalPERS' federal representative will continue to work closely with Congressmen Brady and Neal to address the issues that delayed consideration of H.R. 711 and to explore ways to overcome some of the negative results of the SSA Actuary's revised analysis. We will continue to communicate with CalPERS staff as these efforts advance and will continue to include outreach to key members of the California Congressional Delegation as appropriate.

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 Ways and Means Committee Press Release on Secure Choice-type Plans

     - The Republicans on the Ways and Means Committee issued a press release casting the new state-run, retirement plans for private sector workers as "Obamacare for Retirement."
     - The press release states that state-run, private sector plans could lead to fewer private sector plans overall and less consumer protection for savers.
     - It also levels an attack on public plans, in general, stating that the government has a terrible track record of managing retirement plans and linking to articles by long-time public pension critics Andrew Biggs and Joshua Rauh.

   - California Secure Choice Plan

     - On September 29, Governor Jerry Brown signed legislation that clears the way for the Secure Choice Retirement Savings Board to start the program by 2018. This could make California the first state to implement a retirement savings program for private sector workers. Illinois, Oregon, Massachusetts and New York are also working toward similar programs.
     - Employers must inform employees of their option to invest through Secure Choice and employees may opt out. Depending on the final program design, employees will be able to contribute between two and five percent of their earnings.

   - New York City Retirement Plan for Private Sector Workers

     - New York City Comptroller Scott Stringer announced the New York City Nest Egg retirement program, a comprehensive approach to retirement plan access for workers who currently do not have access to an employer-provided retirement plan. An estimated 1.5 million private sector workers in New York City lack access to retirement plans through their employer or business.
     - The new proposal is forward-looking and anticipates that the U.S. Department of Labor (DOL) will finalize a proposed rule that would allow political subdivisions of states to create auto-enrollment, IRAs for private sector workers. The proposed rule was released in August at the same time DOL finalized its rule allowing states to create such entities without triggering the Employee Retirement Income Security Act (ERISA).

   - Overlapping City and State Retirement Plans for Private Sector Workers

     - As mentioned above, DOL is working toward finalizing a proposed rule that would allow political subdivisions of states to create auto-enrollment, IRAs for private sector workers.
     - As currently drafted, a political subdivision would not be eligible to create such a plan if it was located in state that has a state-wide retirement savings program for private sector workers. New York City, Philadelphia and Seattle have each expressed interest in city-run plans, with New York City being the furthest along in its efforts.
     - In comment letters on the proposed rule, Seattle and Washington State both contend that, while a state marketplace or clearinghouse is helpful for small businesses seeking to identify retirement plan options and then establish their own retirement savings plan, a marketplace is not a retirement plan itself and offers only limited help to workers who lack access to retirement benefits.

  - DOL's proposed regulation may be modified to allow state and political subdivision plans to coexist in certain scenarios, such as where only a marketplace exists and not an actual state-run, retirement plan for private sector workers.
  - It should be noted that there are two additional eligibility requirements for political subdivisions in the proposed rule: (1) Explicit or implicit authority under state law to require employers to participate in a payroll deduction savings program; and (2) a population of at least that of the least-populated state.

3. Implications for CalPERS:

   As a national and state leader in the retirement security arena, CalPERS offered its support for state-run savings arrangements in communication with DOL. The expansion of retirement savings programs is consistent with CalPERS policy.

4. CalPERS/Federal Representative Actions:

   CalPERS' federal representatives have continued to monitor activity regarding the DOL rule and related state-based activity that could inform and/or influence Congressional and/or administrative actions regarding state-based retirement savings plans.

5. Recommendations for Next Steps:

   In general, CalPERS' federal representatives will continue to monitor state and local activity to establish retirement savings programs. More specifically, given the recent engagement by the House Ways & Means Committee, representatives will monitor possible Congressional activity to impact the DOL rules.

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:

   There have been no new developments since our last report.

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:

   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. **Economic Impact of Pension Distributions –** A new report released by the National Institute on Retirement Security (NIRS) analyzed data on defined benefit pension plans in both the public and private sectors to assess the overall national economic impact of benefits paid by these plans to retirees. The data showed that approximately $520 billion in pension benefits were paid in 2014 and those benefits supported some 7.1 million jobs. This generated $1.2 trillion in total economic output nationwide and $190 billion in local and state tax revenue.

2. **Pension Fund Investment Returns –** According to the Wilshire Trust Universe Comparison Service, public pension plans had a median increase of one percent for the fiscal year that ended June 30. That is the lowest median rate of return since 2009, when the median plan lost 16.2 percent. The average assumed rate of return for public plans is 7.6 percent.

3. **House Multiemployer Pension Hearing –** On September 22, the House Education and the Workforce Committee's Subcommittee on Health, Employment, Labor and Pensions held a hearing on a discussion draft to modernize private sector multiemployer pensions. Full Committee Chairman John Kline (R-MN) released the discussion draft. It would authorize so-called composite pension plans, which are also called shared risk or defined ambition plans. The plans would provide a variable benefit based on the market value of assets. They would not be insured by the Pension Benefit Guaranty Corporation. It is likely that Chairman Kline, who is retiring at the end of this Congress, will aggressively advocate for inclusion of the composite plan proposal in year-end legislation.

4. **Social Security Shortfall –** A recent report by the Committee for a Responsible Federal Budget found official estimators disagree on the extent of the program's financial woes. The Social Security Trustees project the program's trust funds face a 75-year gap equal to 2.7 percent of payroll and will be depleted by 2034. However, the Congressional Budget Office projects a trust fund gap equal to 4.7 percent of payroll and a depletion date of 2029.

5. **State and Local Developments That Impact the National Discussion –**

   - **Chicago's Credit Rating and Pension Liabilities –** S&P Global Ratings raised Chicago's credit outlook from negative to stable after the city authorized higher utility taxes to shore up funds for the municipal workers' retirement system, which currently is Chicago's most underfunded pension plan. S&P also affirmed the city's BBB+ ranking on its general obligation bonds. In addition to higher water and sewer taxes, Chicago raised property taxes to bolster the public safety pensions and intends to use telephone surcharges to aid the laborers' retirement system. The state legislature needs to approve the negotiated changes to the pensions' funding schedules and employee contributions.

   - **Dallas' Credit Rating and Pension Liabilities –** Dallas' rating on $1.7 billion of general obligation bonds was downgraded from AA+ to AA by Fitch Ratings. Fitch cited growing pension liabilities in the Police and Fire Pension System as the principal reason. While the city ended fiscal year 2015 with a net surplus of $19.4 million, reserves of $181.7 million and a balanced budget for 2016, the plan's funded ratio is only 45 percent.

   - **Oklahoma's New 401(k) Plan –** On October 11, the Oklahoma Supreme Court upheld the Oklahoma Retirement Freedom Act, which creates a 401(k)-like plan for new state employees. In the case, Stevens v. Fox, the court rejected the argument that the new retirement law was unenforceable because it violated the process outlined in the Oklahoma Pension Legislation Actuarial Analysis Act for introducing, hearing and passing retirement legislation. The court held that a violation of legislative procedure cannot be the basis for finding an illegal expenditure of public funds.

Employees and taxpayers have another opportunity to overturn the law. The case was remanded to district court to determine the taxpayers' claim that assets from the current pension plan were used to pay upfront administrative costs to establish the new system. These expenses, they argue, were not used for the exclusive benefit of participants of the current pension plan.

- **Court Action on Detroit Pension Cuts –** On October 3, the U.S. Sixth Circuit Court of Appeals dismissed challenges to any reductions in certain municipal employee pension benefits under Detroit's General Retirement System (GRS) contained as part of the city's comprehensive bankruptcy plan and ratified in a final Confirmation Order. The Global Retiree Settlement reduced all GRS pensions by 4.5 percent; eliminated cost-of-living increases; reduced retiree healthcare coverage; eliminated dental, vision and life insurance; and set out a mechanism for the partial recoupment of certain excess distributions. Retirees argued unsuccessfully that the bankruptcy judge lacked authority to override the Michigan Constitution's protections of public pensions.

- **Houston Mayor Proposes Bond Sale for City's Pensions –** Houston Mayor Sylvester Turner has proposed selling $1 billion in pension obligation bonds and investing the proceeds in the city's pension funds. The sale would be part of a broader overhaul that includes preliminary agreements with the city's pension plans on pension restructuring.

- **Kentucky's Pensions –** Kentucky House Speaker called lawmakers back to the state House for a meeting to address pension investment losses. A report released earlier this year showed that Kentucky pensions payed $171 million to investment managers, even though the funds lost money on their investments. New Republican Governor Matt Bevin is seeking to take control of state pensions and change the investment policy. Kentucky owes $35 billion in retirement benefits and is falling behind on payments at a faster rate than any other state. After failing to adequately fund the plan 15 of the last 22 years, state lawmakers allocated $1.28 billion this year, more than what is required, but still not enough to bridge the gap.