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Federal Retirement Report for CalPERS Board
November 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:

   Retirement Enhancement and Savings Act of 2016 (S. 3471) and Miners Protection Act of 2016 (S. 3470)

   - Senate Finance Committee Chairman Orrin Hatch (R-UT) introduced the Retirement Enhancement and Savings Act of 2016 (S. 3471), which would increase access for workers in small companies to retirement plans by authorizing multiple-employer, defined contribution plans.
   - Senate Finance Committee Ranking Member Ron Wyden (D-OR) introduced the Miners Protection Act of 2016 (S. 3470), which would expand the group of coal miners covered by the 1993 UMWA Health Benefit Plan and also direct transfers amounts in the UMWA Health Benefit Plan to the UMWA Pension Plan up to the annual limit of $490 million in the aggregate.
   - CalPERS' retirement policy consultants have been monitoring any legislation – such as the Retirement Enhancement and Savings Act of 2016 (S. 3471) and Miners Protection Act of 2016 (S. 3470) – to prevent the inclusion of unrelated retirement provisions – such as H.R. 4822 – that would threaten the independence of state and local pension plans.
   - At this point, neither bill includes any provisions related to state and local governmental pension plans, such as PEPTA (H.R. 4822) or the annuity accumulation plan.
   - It remains unclear whether S. 3471 or S. 3470 will be considered during the lame-duck session.

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 oppose any efforts to include unrelated provisions – such as H.R. 4822 – to any pension-related legislation.

5. Recommendations for Next Steps:

   The CalPERS' retirement policy consultants will continue to monitor any legislation – such as the Retirement Enhancement and Savings Act of 2016 (S. 3471) and Miners Protection Act of 2016 (S. 3470) – to prevent the inclusion of unrelated retirement provisions (such as H.R. 4822) that would threaten the independence of state and local pension plans.

   In addition, CalPERS retirement policy consultants will be meeting with several members of the California Congressional Delegation during the lame duck session to discuss CalPERS retirement priorities and concerns regarding the possibility of unrelated provisions that would threaten the status 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, Senate Finance Committee Chairman Orrin Hatch (R-UT) introduced the Retirement Enhancement and Savings Act of 2016 (S. 3471), and Senate Finance Committee Ranking Member Ron Wyden (D-OR) introduced the Miners Protection Act of 2016 (S. 3470). At this point, neither bill includes any provisions 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 regards the annuity accumulation plan 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:

   As noted in Item A, CalPERS' retirement policy consultants have been working with other public plan advocates to oppose 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 Retirement Enhancement and Savings Act of 2016 (S. 3471) and Miners Protection Act of 2016 (S. 3470)

– to prevent the inclusion of unrelated retirement provisions (such as H.R. 4822) that would threaten the independence of state and local pension plans.

In addition, CalPERS retirement policy consultants will be meeting with several members of the California Congressional Delegation during the lame duck session to discuss CalPERS retirement priorities and concerns regarding the possibility of unrelated provisions that would threaten the status of state and local pension plans.

II. Developments in Advancing Retirement Savings and Retirement Security

A. 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:

   Rep. Sander Levin (D-Mich) has announced that he won't seek re-election to the ranking member's position on the Ways and Means Committee. Mr. Sander's decision clears the way for Rep. Richard Neal to be elected the ranking member. We had expected Mr. Neal to be challenged for this position by Rep. Xavier Becerra; however, Mr. Becerra's decision to leave Congress to become California's Attorney General eliminated that potential contest. It's also important to note that as a result of Mr. Becerra's departure, Rep. Mike Thompson – a co-sponsor of H.R. 711 – is now the most senior California Democrat on the Ways & Means Committee.

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% for the first 10 years and up to 50% thereafter; on average, future retirees will see a reduction approximately 35% 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:

   As noted in Items A & B, CalPERS retirement policy consultants will be meeting with several members of the California Congressional Delegation during the lame duck session to discuss CalPERS retirement priorities; CalPERS support for H.R. 711 will be included in those discussions.

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. In addition, discussions are underway to support the reintroduction of The Equal Treatment of Public Servants Act early in the new Congress. 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) has finalized a rule to 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. DOL is currently developing a similar rule for political subdivisions.

2. Specific changes/developments since last report:

   Changes at the DOL as a result of the election of Donald Trump will likely make regulations regarding secure choice plans a target for legislative and/or regulatory reform efforts. Options with regard to the ERISA safe harbor rules for state-run, auto-IRA plans for private sector workers are being examined. Although the rule for state-run plans is final and the effective date has passed, it could still be overturned by application of the Congressional Review Act.

   When the state-run plan rule was released it was accompanied by DOL Interpretative Bulletin (IB) 2015-02, which was effective November 18, 2005. The IB provided three approaches within ERISA for a state to pursue: state-administered prototype plans; marketplace programs; and state-administered multiple employer plans. IBs may be withdrawn at any time.

   Finally, the rule that would extend the state-run, auto-IRA to political subdivisions has been issued only in proposed form. Unless it is made final and effective immediately, it is likely to languish in the Trump Administration's DOL.

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. Given the likely changes in DOL policy, federal representatives will consult with CalPERS staff to evaluate options for future engagement in support of state-based retirement initiatives.

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. **ALEC Report and Heritage Foundation** – Longtime critic of public pension plans, the American Legislative Exchange Council (ALEC), released a report examining state and local governments' unfunded pension liabilities. The report calculates the unfunded liabilities at nearly $5.6 trillion. It uses a 2.344 percent rate of return, which is an average of 10-year and 20-year Treasury bond yields. In a coordinated attack, the Heritage Foundation hosted an event titled, *Unaccountable and Unaffordable: How State and Local Governments Have Racked Up Nearly $5.6 Trillion in Unfunded Pension Promises and What They Can Do About It*. The event addressed the findings in the ALEC report.

2. **Trump Administration, 115th Congress and Federal Workers –** An article published by the Washington Post examines what the incoming Trump Administration may mean for federal employees. President-elect Trump ran on promises to shrink the size and reach of government, including eliminating some agencies and running the bureaucracy with fewer people. There is speculation that the changes may include paring back retirement benefits. Rep. Jason Chaffetz (R-UT), Chairman of the House Committee on Oversight and Government Reform, said he plans to advocate changes to the retirement benefits that federal workers receive by shifting to a 401(k)-style plan for new employees. Chairman Chaffetz intends to model his plan after his home state of Utah, which six years ago replaced its defined benefit pension plan with a defined contribution plan for new state and municipal workers.

3. **Fiduciary Rule –**

   - The U.S. District Court for the District of Columbia is the first court to issue a ruling on the legal challenges to DOL's fiduciary rule for retirement investment advisors. The National Association for Fixed Annuities (NAFA) argued in its lawsuit that DOL went beyond its statutory authority when it extended the reach of the Employee Retirement Income Security Act to individual retirement accounts. Judge Randolph Moss rejected these arguments in his November 4 decision; denied NAFA's motion for a temporary block of the rule; and granted DOL's motion for summary judgment. However, this legal victory may be short-lived. Given the complexity and controversy surrounding the fiduciary rule, it will be a prime target for the regulatory reform efforts of the incoming Trump Administration.
   - Groups that oppose the DOL's fiduciary rule appear to be coalescing around a request that the incoming Trump Administration delay the effective date of the rule for two years. The effective date is currently set at April 10, 2017. This would allow time for the rule's opponents to develop a plan to re-propose the rule with modifications or seek a legislative solution to the issue.

4. **Death Master File** – On November 16, the National Council on Teacher Retirement (NCTR) held a webinar to discuss access to the Social Security Administration's (SSA) Death Master File (DMF). Panelists described the challenges in identifying deceased beneficiaries without access to the DMF. Representatives from state retirement programs discussed the different methods used to determine a beneficiary's status including sending proof of life letters. All participants agreed nothing is an adequate replacement for access to the full DMF.

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

    - **Warning from Illinois -** On October 12, Illinois announced to potential bond buyers that it may not have enough money to make its fiscal 2017 pension payments. The state said that it is possible the five retirement systems may not receive payments when due because the state's general fund may be low on cash. Illinois owes the pension funds $7.826 billion in fiscal 2017, which ends June 30. Without full and timely payments, the pension funds may have to sell assets to cover retirement distributions. Illinois has the lowest credit rating among the states. A budget impasse and $111 billion unfunded pension liability have contributed to the low investment-grade level rating of triple-B.

    - **Alaska Scraps Bond Sale for Pension Plan –** Alaska has decided not to move forward with a $2.4 billion bond measure intended to fund the state public employee's retirement fund. The taxable bond offering, which was planned for October 26, was taken off the table because of a lack of support among state legislators. Growing speculation that the Federal Reserve will tighten monetary policy in December contributed to the measure's demise. In a letter dated October 19, state senate finance committee members suggested the Governor consider other measures, such as infusing the retirement system with general funds.

    - **Pension Changes in Dallas –** On November 13, Texas Judge Ken Molberg indefinitely delayed an election to determine whether Dallas police and firefighters would accept benefit cuts and increase their pension contributions. The halt came after firefighters and police officers filed a lawsuit against the Dallas Police and Fire Pension System challenging the expansion of the board of trustees over the past two decades. The shortfall to the Dallas Police and Fire Fund was $3.3 billion at the beginning of 2016. The City has little authority to close the gap through benefit adjustments. Such a move must be authorized by the Texas legislature or the members of the pension fund. In an attempt to reduce the unfunded liability of the plan, the board proposed increasing employee contributions, changing how future benefits are calculated, and limiting a program that allows employees to reinvest their pensions at guaranteed rates of return if they agree to stay on the job after they're eligible to retire (deferred retirement option plan or DROP).

    - **New Jersey's Bond Rating –** On November 14, New Jersey's bonds were downgraded from A to A- by S&P Global Ratings as a result of the financial pressure caused by the state's debt to its workers retirement system. This most recent downgrade marks the state's tenth downgrade from the three major ratings companies since 2010. While an A- rating is still investment grade, S&P maintains a negative outlook on the state, meaning it could be downgraded yet again. New Jersey recently topped Illinois as the most underfunded state pension system in the country, with an estimated $135.7 billion shortfall.