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Federal Retirement Policy Report for CalPERS Board

November 2017

I. DEVELOPMENTS IN PROTECTING PUBLIC SECTOR DEFINED BENEFIT PLANS

CalPERS' 2017 Federal Retirement Security Priorities advocate for the preservation of defined benefit retirement plans and against federal incentives or options to replace defined benefit pension plans and federal intervention in state and local pension plans.

- New Developments Since Last Report:

  - **CBO Study** – The Congressional Budget Office (CBO) released a new report entitled Measuring the Adequacy of Retirement Income: A Primer, which explains the various measures of benefit adequacy. Previously, adequacy of retirement income has been defined in one of two ways: basic needs or standard of living. The new report suggests utilizing different measures for retirement income adequacy: single-year analysis and multi-year analysis –
    - Single-Year Analysis: This approach analyzes retirement income in a single year of retirement, "providing a snapshot of retirement adequacy at a given point in time." The CBO notes that this approach works regardless of which definition of adequacy is used.
    - Multi-year Analysis. This approach reflects the reality that, as CBO explains, "financial security is dynamic and may change as retirees' spending patterns evolve." Thus, "studies that look at multiple years can show whether or not retirees are able to maintain their standard of living as their needs change over time," unlike single-year analyses.

    The estimated share of current workers who were at risk of having inadequate income ranged from about one-third to two-thirds; however, they differed on the details. CBO says that researchers conclude that less than one-tenth of retirees will have income below the poverty threshold, but a much larger fraction of people are projected to have income that will fall short of maintaining their pre-retirement standard of living.

  - **Pension Rehabilitation Fund –** Senator Sherrod Brown (D-OH) and Rep. Tim Ryan (D-OH) announced that they will be introducing legislation on a proposal to create a new Pension Rehabilitation Administration (PRA) within the Treasury Department. The PRA would allow multi-employer pension plans to borrow funds in order to remain solvent. Money for the loans and the cost of running the PRA would come from the sale of Treasury-issued bonds. The loans to the pension plans would be for 30 years at low interest rates.

  - **Retirement System Reevaluation –** On November 14, the Georgetown Center for Retirement Initiatives held a webinar entitled The U.S. Retirement System: Is It Time for a Comprehensive Reevaluation? It discussed a recent Government Accountability Office (GAO) report to Congress on the state of the U.S. retirement system. GAO concluded a more comprehensive national reevaluation of our retirement programs is needed. The last review was done almost 40 years ago. The webinar can be viewed here.

- CalPERS Implications and Next Steps:

Research and ongoing debate regarding the state of retirement security has the potential to impact Federal legislative and regulatory activity that could undermine support for defined benefit retirement plans resulting in negative implications for CalPERS and other public pension plans. We continue to monitor this debate and any related legislative and regulatory activity. In addition, we advocate against any pension related legislation that proposes PEPTA, the annuity accumulation plan, amended bankruptcy provision for state governments, and/or any proposal that could serve as a vehicle for similar anti-DB pension plan provisions.

- CalPERS/Federal Representative Actions:

  Your federal representatives continue to network with members of the public pension network in Washington, D.C. and other public plans around the country. This engagement includes a discussion of tax reform and the issues that may be in play as the legislation moves through the legislative process, including the change to mandatory Roth contributions, the Public Employee Pension Transparency Act, the annuity accumulation plan, the elimination of the federal tax deduction for state and local taxes, and the application of UBIT to public retirement systems.

- Recommendations for Next Steps:

  With the exception of activity related to tax reform which is discussed later in this report, there are no specific next steps at this point.

II. DEVELOPMENTS IN ADVANCING RETIREMENT SAVINGS AND RETIREMENT SECURITY FOR ALL EMPLOYEES

A. The Equal Treatment of Public Servants Act (H.R. 711 – 114th Congress) (Brady-Neal)

1. The Equal Treatment of Public Servants Act - 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 result in lower reductions for future retirees through the application of a new formula based on each worker's actual work history.

2. Specific changes/developments since last report:

   There have been no specific developments since the last report. *[NOTE – Based on conversations with staff for Mr. Brady and Mr. Neal, it's likely there won't be any developments on this legislation until late in 2017.]*

3. Implications for CalPERS:

   The passage of the Equal Treatment of Public Servants Act 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 a revised SSA actuarial analysis.

4. CalPERS/Federal Representative Actions:

   On November 1st, CalPERS federal representative Tom Lussier (The Lussier Group) met with the Staff Director of the House Ways & Means Social Security Subcommittee to discuss the committee's plans to advance the Brady-Neal WEP reform legislation prior to the end of 2017. Staff confirmed the chairman's commitment to advance his WEP reform this year; however, they acknowledged the effort currently being expended to advance comprehensive tax reform legislation. They remain noncommittal regarding what vehicle will be used to move the WEP legislation.

5. Recommendations for Next Steps:

CalPERS' retirement policy consultants will continue to communicate with staff for Chairman Kevin Brady (R-TX) and Ranking Member Richard Neal (D-MA) to coordinate activity in support for the Equal Treatment of Public Servants Act and will communicate with CalPERS staff to determine when additional engagement is appropriate, including outreach to the California Congressional Delegation.

B. Fiduciary Rule –

1. The Department of Labor (DOL) issued a rule that imposes a fiduciary standard on financial firms and advisers providing retirement advice. The rule became effective on June 9, 2017.

2. Specific changes/developments since last report:

- On November 1, the DOL transmitted to OMB a proposed final rule titled *18 Month Extension of Transition Period and Delay of Applicability Dates, Best Interest Contract Exemption; Class Exemption for Principal Transactions; PTE 84-24.*

- On November 27, DOL announced the official 18-month extension for the start of key provisions of the fiduciary rule. The announcement included a special Transition Period for the Fiduciary Rule's Best Interest Contract Exemption and the Principal Transactions Exemption, and of the applicability of certain amendments to Prohibited Transaction Exemption 84-24 (PTEs), (will move from the previous Jan. 1, 2018 compliance date to July 1, 2019). The extension is intended to give DOL time "to consider public comments submitted pursuant to the Department's July Request for Information, and the criteria set forth in the Presidential Memorandum of Feb. 3, 2017.

3. Implications for CalPERS:

CalPERS has been supportive of the fiduciary rule. As a national and state leader in the retirement security arena, CalPERS has an interest in the full implementation of the rule – especially as it might impact retirement security in California.

4. CalPERS/Federal Representative Actions:

CalPERS retirement policy consultants will continue to monitor any activity regarding the rule and will communicate with CalPERS staff to determine whether additional engagement is appropriate.

5. Recommendations for Next Steps:

There are no specific next steps at this point.

C. State-Based Retirement Programs –

1. The Department of Labor (DOL) finalized a rule to facilitate the creation of state and political subdivision-based retirement plans such as California's Secure Choice plan. The rule was intended to enable states to initiate innovative ideas that will boost overall retirement savings. The President signed a resolution (H.J. Res 66) passed by Congress to nullify the DOL rule.

2. New Development Since Last Report:

There have been no significant developments since the last report.

3. Implications for CalPERS:

As a leader in the retirement security arena, CalPERS has an interest in efforts that will boost overall retirement savings; especially those that would impact retirement security in California. We will evaluate other opportunities for CalPERS to engage in this important national discussion.

4. CalPERS/Federal Representative Actions:

   CalPERS retirement policy consultants continue to monitor any activity regarding H.R. 2523 and S. 1035, the PROSPERS Act (legislation that would amend ERISA to specifically exclude from its scope certain IRA-based retirement plans run by state or political subdivisions for private sector workers) and any related regulatory activity and will communicate with CalPERS staff to determine whether engagement is appropriate.

5. Recommendations for Next Steps:

   There are no specific next steps at this point.

D. Other Retirement-Related Legislation/Activity –

Tax Reform – Congress is actively considering tax reform legislation that could impact CalPERS.

1. Development Since Last Report:

   - The House approved its version of tax reform on November 16 by a vote of 227-205. All Democrats and 13 Republicans voted against the bill. As passed by the House, H.R. 1 includes a provision that would subject state and local governmental pension plans to the unrelated business income tax (UBIT) on certain investments beginning in tax year 2018. The House-passed bill does not contain any changes to non-qualified deferred compensation, section 457(b) plans or catch-up contributions. In addition, PEPTA, Rothification and the annuity accumulation plan are not included in the House-passed bill.

   - The Senate Finance Committee approved its version of tax reform also on November 16 on a party line vote. The legislation will be on the Senate floor during the week of November 27.

   - As the Senate bill stands, (1) it does not include the House UBIT provision but does include a provision that would require UBIT to be calculated on a trade/business per trade/business method (individually); the Senate provision would not apply to state and local governmental plans, unless the House provision is also enacted; and (2) it includes a provision that would prevent a participant from maxing out the contributions to both a 403(b) and 457(b) plan; this provision also repeals all special rules related to post-employment contributions to 403(b) plans and catch-up contributions to 457(b) plans within three years of reaching normal retirement age. Provisions related to non-qualified deferred compensation, subjecting 457(b) plans to the early withdrawal penalty, and preventing a taxpayer who had wages of $500,000 or more in the preceding tax year from making a catch-up contribution have been dropped. In addition, PEPTA, Rothification and the annuity accumulation plan are not included in the Finance Committee bill.

2. Implications for CalPERS:

   - From a positive perspective, neither H.R. 1 nor the Senate bill contains any provisions related to Rothification, PEPTA or the annuity accumulation plan.

- As approved by the House, H.R. 1 would subject certain investments of state and local governmental pension funds to the unrelated business income tax (UBIT) beginning in tax year 2018. CalPERS staff has indicated that such a tax could have a significant impact on the fund.

- Legislation approved by the Senate Finance Committee does not include the House provision; however, it does contain a provision that would require UBIT calculations to be done on a trade/business basis, each separately. If both the House and Senate provisions are enacted, it would become a costly and administratively burdensome new tax on public plans.

3. CalPERS/Federal Representative Actions:

- CalPERS federal representatives contacted key CA delegation offices (House Leader Kevin McCarthy, Minority Leader Nancy Pelosi, the three CA Democrats on the House Ways and Means Committee, and the two CA Senators) to advocate for the removal of the House UBIT provision. In addition, all Republicans in the CA Congressional Delegation have been contacted.

- The public plan community is united in opposing the extension of UBIT. NCPERS-NASRA-NCTR released a joint letter in opposition to the House provision.

- CalPERS federal representatives have been in constant contact with the three largest national trade association for public plans – NCPERS, NASRA and NCTR – as well as strategically-located individual plans in Ohio, Texas, Utah and Tennessee. We have also been working with the International Association of Fire Fighters and Fraternal Order of Police.

4. Recommendations for Next Steps:

CalPERS federal representatives, in conjunction with CalPERS staff, will continue to engage with national trade associations, strategically-located individual plans in Ohio, Texas, Utah and Tennessee, and key labor organizations such as the International Association of Fire Fighters and Fraternal Order of Police to address public plan concerns.

III. Other Updates and Information

- **Canadian Pension System –** On November 2, the Brookings Institute hosted a panel discussion, Fixing the U.S. Retirement System – Does Canada Have the Answers? During the event, which featured senior members of the Canadian Labor Congress as well as American retirement experts, panelists discussed the features of the Canada Pension Plan and its relevance to American retirement policy. Canada recently expanded its pension system while avoiding many of the funding problems US-based plans are facing. Panelists suggested part of the difference could be attributed to the fact that the Canadian actuarial profession is and has been more conservative in its approach to pensions. CalPERS was cited as a positive example of a large public pension plan that has engaged in direct investment. CalPERS was also praised by the panel for their decision to divest from certain industries and to discontinue contracts with investment firms because of excessive fees.

- **Funding for Connecticut's Pensions –** The budget recently signed by Connecticut Governor Dannel Malloy (D) contained a study to consider using capital assets to partially fund the state pension system. The study commission would consist of 13 members appointed by various government entities, including the governor and House and Senate leaders. It would perform a preliminary inventory of state capital assets to determine their sustainability and potential for reducing the state pension's unfunded liability. The commission will then make recommendations on the appropriateness of the capital asset approach and the steps necessary to establish a separate trust. The assets would be managed through a professionally-run trust fund established by the Connecticut Pension Sustainability Commission.

- **Treasury Report –** A new report from the U.S. Treasury Department examined the current regulatory framework for the asset management and insurance industries focused on four areas: the proper evaluation of systemic risk, ensuring effective regulation and government processes, rationalizing international engagement, and promoting economic growth and informed choices. One recommendation was strengthening consumer access and choice with respect to annuities as investment options within employer-sponsored retirement plans. The full report can be read here.

- **Investment Returns for Public Pensions –** According to Wilshire Trust Universe Comparison Service, the median return for public pension plans in the quarter that ended September 30 was 3.5 percent. That marks the eighth consecutive quarter of positive returns for state and local plans.