MAY 2013

May was scandal month in Washington, at least for many Republicans who spotted a series of vulnerabilities at the White House. The Obama administration had to defend itself against GOP-led congressional inquiries on three issues – its reaction to the terror attack in Benghazi that killed four Americans in September 2012; the IRS targeting of conservative non-profit groups for extra scrutiny; and the Department of Justice subpoenaing the phone records of Associated Press reporters and launching an investigation of a Fox News reporter as part of a campaign against leaks of sensitive information. The latter inquiry included a court filing that asserted there is evidence that the reporter broke the law, "at the very least, either as an aider, abettor and/or co-conspirator." The tornado that killed 24 people in Oklahoma put things on hold, but hearings will likely resume on all three matters when Congress returns from its Memorial Day recess.

ISSUES AND EVENTS

DOJ Official Says No One Immune from Prosecution for Financial Crimes

A senior Department of Justice (DOJ) official, addressing concerns that some financial firms are "too big to jail," told a congressional panel in May that, "No individual or institution is immune from prosecution."

Several lawmakers from both parties have complained that the Obama administration has not been aggressive enough in prosecuting officials at very large financial firms when they commit offenses because of fear of the impact it would have on the nation's financial system.

At a May 22 hearing of the House Financial Services Committee's Oversight and Investigations Subcommittee, Acting Assistant Attorney General Mythili Raman noted that, "the U.S. Attorneys' Manual requires federal prosecutors to consider the potentially adverse impact a prosecution may have on investors, pension holders, customers, employees and the public, including on innocent people who had nothing to do with the criminal conduct."

Raman insisted, though, that those considerations do not shield anybody from the law. "None of the factors set forth in the U.S. Attorneys' Manual that I've mentioned, including potential collateral consequences, acts as a bar to prosecution, or has prevented the Justice Department from aggressively pursuing investigations and seeking criminal penalties in cases involving large, complex financial institutions," Raman said. "No individual or institution is immune from prosecution, and we intend to continue our aggressive pursuit of financial fraud with the same strong commitment with which we pursue other criminal matters of national and international significance."

Attorney General Eric Holder told the Senate Judiciary Committee on March 6 that he is "concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute. If you do bring a criminal charge, it will have a negative impact on the national economy, perhaps even the world economy." He has backed away from those comments, though, and told the House Judiciary Committee on May 15 that, "there's no bank, there's no institution, there's no individual who cannot be investigated and prosecuted by the United States Department of Justice."

The Oversight and Investigations Subcommittee has asked the Justice Department, the Treasury Department, the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Financial Research and the Financial Stability Oversight Council what outside experts DOJ has consulted with in arriving at Holder's March conclusion about the negative impact of a criminal charge against a large firm.

"To date, the subcommittee's investigation has indicated that the Justice Department has not received any material information from outside experts," subcommittee Chairman Patrick McHenry, R-N.C., said. "DOJ has provided nothing material to explain the comments made by the attorney general. … The attorney general's contradicting comment does not explain whether the department's view of the collateral harm of convicting a financial institution has changed or, if the department's view has not changed, the circumstances in which a party's criminal conduct is so egregious that prosecution is appropriate even in the face of significant harm to innocent parties."

McHenry and Financial Services Committee Chairman Jeb Hensarling, R-Texas, wrote to Treasury Secretary Jacob Lew on March 8 to "express our deep concern" over Holder's comments as well as remarks by Treasury Undersecretary Jacob Cohen at a March 7 Banking Committee hearing regarding Treasury's decision not to provide the Justice Department with an opinion concerning the potential impact on the financial system if money laundering charges were filed against HSBC. Lew said in March that, "It is very much my view, it is our view, that no one or no company is above the law."

Lew testified at a May 21 hearing of the Senate Banking, Housing and Urban Affairs Committee at which Sen. Elizabeth Warren, D-Mass., asked him about the possibility of capping the size of financial institutions as a way to end "too big to fail." Noting that banks are 30 percent larger than they were during the financial crisis of the late 2000s, that "It's been one scandal breaking on top of another … It's clear they have not changed their risk-bearing practices, nor have they decided that they're going to start following the law," and that Holder indicated that large size may discourage prosecutions, Warren asked Lew if he would support such a cap. Lew said that regulators first need to finish implementing the 2010 Dodd-Frank Act, "and then take stock of whether or not there are other actions that are required."

Unsatisfied with that answer, Warren asked, "How big do the biggest banks have to get before we consider breaking them up? … When we see the largest financial institutions getting bigger and bigger, that … tells us that we are not clearly on the path to resolving 'too big to fail.'"

Lew responded that size is not the only issue, and that "we have to consider all of the factors that, together, add up to systemic risk."

CalPERS Advocates Against Three Proposed Dodd-Frank Revisions

CalPERS in May submitted a statement to a House subcommittee to oppose three bills backed by the panel's Republican leadership that would repeal portions of the 2010 Dodd-Frank Act.

The House Financial Services Committee's Capital Markets Subcommittee met on May 23 to consider the bills that subcommittee Chairman Scott Garrett, R-N.J., said would "fix many of the unnecessary provisions of the Dodd-Frank Act, freeing up [Securities and Exchange Commission (SEC)] resources to be devoted to mission-critical rules."

The "Burdensome Data Collection Relief Act" (H.R. 1135) would eliminate a requirement that public companies include in their proxy statements information that allows shareholders to compare the compensation of the firm's executives to its financial performance. In its statement, CalPERS acknowledged that amending the provision may be appropriate because, as written, it "is unartful and its critics properly identify a number of potential ambiguities."

"However, we strongly support the spirit of the disclosure and believe that the SEC has the regulatory flexibility to provide companies with guidance on how to comply with this section," the statement asserted.

The "Small Business Capital Access and Job Preservation Act" (H.R. 1105) would exempt advisors to private equity funds with low leverage ratios from the requirement that they register with the SEC. CalPERS objected that this "would constitute a large step away from the comprehensive regulation of market participants that Dodd-Frank sought to impose."

The "Audit Integrity and Job Protection Act" (H.R. 1564) would prohibit the Public Company Accounting Oversight Board (PCAOB) from requiring that the audits of a particular issuer be conducted by specific auditors, or that such audits be conducted by different auditors on a rotating basis. CalPERS, while noting that "audit committees are in the best position to select the auditor," stated, "we are strong supporters of the PCAOB and have faith in their thoughtful approach to the regulation of the audit profession. If they ultimately conclude that mandatory rotation is appropriate, we will support this judgment."

Although regulatory agency appropriations were not a focus of the hearing, CalPERS concluded its statement by asserting that regulators should be provided with adequate funding.

"It remains imperative that the SEC and [the Commodity Futures Trading Commission] be given sufficient resources to effectively police the U.S. capital and futures markets," CalPERS stated.

Administration Opposes Bill to Require SEC Cost-Benefit Analyses

The Obama administration has come out against a bill that would require the Securities and Exchange Commission (SEC) to conduct cost-benefit analyses of proposed rules.

By a vote of 235-161, the House on May 17 passed the "SEC Regulatory Accountability Act" (H.R. 1062), which would direct the agency to analyze the costs and benefits – "both qualitative and quantitative" – of rules that it is considering and "propose or adopt a regulation only on a reasoned determination that the benefits of the intended regulation justify the costs of the regulation." It also would require that the SEC "ensure that any regulation is accessible, consistent, written in plain language, and easy to understand and shall measure, and seek to improve, the actual results of regulatory requirements." All House Republicans supported the bill, as did 17 Democrats.

In announcing its opposition, the administration said that the legislation would impose "burdensome and disruptive new procedures" on the SEC and "would impede the ability of the SEC to protect investors, maintain orderly and efficient markets, and facilitate capital formation."

"The Administration believes in the value of cost-benefit analysis," the "Statement of Administration Policy" asserted. "However, H.R. 1062 would add onerous procedures that would threaten the implementation of key reforms related to financial stability and investor protection. H.R. 1062 would direct the SEC to conduct time- and resource-intensive assessments after it adopts or amends major regulations before the impacts of the regulations may have occurred or be known. The bill would add analytical requirements that could result in unnecessary delays in the rulemaking process, thereby undermining the ability of the SEC to effectively execute its statutory mandates."

On May 15, CalPERS wrote to the members of California's congressional delegation to express "strong concerns" about the bill.

"The legislation would threaten the efficient implementation of many important financial regulatory rules by imposing unnecessary requirements upon the Securities and Exchange Commission," CalPERS stated in the letter. "We fear the requirement to create a myriad of new economic analyses is intended to derail the efforts of the Commission to implement important legislation like the Dodd-Frank Wall Street Reform and Consumer Protection Act while its opponents continue to attempt to repeal or significantly water down important investor protections."

Senate Bill Drops Disclosure Exemption Favored by Oil Industry

Recently introduced Senate legislation that would implement an oil agreement between the United States and Mexico does not contain an industry-favored exemption from disclosure rules that was included in a related House bill.

The U.S. and Mexico signed an accord in 2012 regarding oil and gas exploration in the Gulf of Mexico. A House bill that would implement that pact would exempt energy companies from a rule approved by the Securities and Exchange Commission (SEC) in August 2012 that requires firms to report payments to foreign governments related to the development of oil and gas fields. The measure was included in the 2010 Dodd-Frank Act to increase the transparency of money flowing to regimes that may be more likely to pocket it than use it for the good of their nation. The House Natural Resources Committee's Energy and Mineral Resources Subcommittee held a hearing on the bill on April 25.

While House Republicans and industry groups say the exemption is needed because of confidentiality provisions in the agreement, a spokesperson for Senate Energy and Natural Resources Committee Ranking Republican Lisa Murkowski of Alaska said that, "Because this is an energy bill and Dodd-Frank falls outside of our committee's jurisdiction, we didn't address it in this bill."

The oil industry filed legal challenges to the SEC rule in both federal district court and federal appeals court, arguing that it imposes overly expensive burdens, puts companies at a competitive disadvantage, and violates the First Amendment by "compelling U.S. companies to engage in costly speech on controversial matters in order to influence political affairs in other nations." The appeals court on April 26, without commenting on the merits of the challenge, dismissed the case, saying it belongs in district court, where it continues.

CalPERS, in February 2011, wrote to the SEC to support the rule, which was then under consideration by the agency, stating that it "is especially vital for companies operating in countries where governance is weak resulting in corruption, bribery and conflict that could negatively impact the sustainability of a company's operations and our ability to more effectively make investment decisions."

GOP Reps. Warn Against Political Disclosure Rule by Citing IRS Scandal

House Republicans in mid-May pressed Mary Jo White, chairman of the SEC, to disavow a possible rule to require corporations to disclose political contributions by invoking the controversy over the IRS targeting conservative organizations for extra scrutiny.

Although the Securities and Exchange Commission (SEC) has not announced plans to propose a rule, staff has been studying the issue following the submission of a petition supporting disclosure that has received more than 600,000 comments. That number is, by far, a record for the SEC on any issue, and most of the comments have backed the potential rule.

During a House Financial Services Committee hearing on May 16, Republicans – who have opposed the disclosure rule all along – used the IRS scandal to argue against it, with Rep. Scott Garrett, R-N.J., chairman of the subcommittee that oversees the SEC, saying he is concerned “about this administration’s bullying of organizations and groups that disagree with them politically.”

“There appears to be a coordinated effort to use any and all methods possible to tamp down on political opposition and – in some cases – stifle some Americans' constitutional right of freedom of speech,” Garrett said.

According to a report released on May 14 by the IRS inspector general, the agency, between 2010 and 2012, “used inappropriate criteria that identified for review Tea Party and other organizations applying for tax-exempt status based upon their names or policy positions instead of indications of potential political campaign intervention.”

“The American people are horrified at those who would use the strong arm of government for partisan political advantage, but it remains to be seen whether this could ever happen at the SEC,” committee Chairman Jeb Hensarling, R-Texas, said.

Garrett urged White to “make a clear and emphatic statement that you will refuse to be bullied by these outside radical groups that are trying to exploit the corporate disclosure process.”

Democratic Rep. Brad Sherman of California saw some irony in that request.

“You’ve been called upon by the chair of the relevant subcommittee,” Sherman said to White, “to resist outside political pressure, refuse to be bullied and to demonstrate the SEC’s independence by immediately acceding to the demands of the chair of the relevant subcommittee and the full committee.”

White, who took over the chairmanship in April, is likely to be the deciding vote on the five-member commission if a disclosure rule is considered. At the hearing, she declined to express her opinion on the issue or indicate if the matter will be taken up by the agency, saying she wants to wait until the SEC staff has completed its work.

“I don’t think I should comment or prejudge [without] the benefit of the staff’s review,” White said. “No one has reached a conclusion if there should be a proposed rule going forward.”

TARP to Cost Federal Government $21 Billion: CBO

The net cost to the federal government of the Troubled Asset Relief Program (TARP) is expected to be $21 billion, according to a report from the Congressional Budget Office (CBO).

TARP was established in October 2008, mostly to provide emergency assistance to financial firms, but it also loaned funds to the automatic industry and was used for mortgage programs. Congress originally authorized up to $700 billion for TARP, but $419 billion has been distributed and another $9 billion is expected to be disbursed, CBO found.

“The estimated cost of the TARP stems largely from assistance to American International Group (AIG), aid to the automotive industry, and grant programs aimed at avoiding home mortgage foreclosures,” the report stated. “Other transactions with financial institutions will, taken together, yield a net gain to the federal government, in CBO’s estimation.”

CBO’s estimate of the net cost of TARP is less than half of the $47 billion that has been projected by the Office of Management and Budget (OMB). Most of the difference results from OMB using a higher estimate of the number of people who are expected to participate in federal mortgage programs.

Hearing Witnesses Back Social Security Coverage for All New Hires

Two witnesses at a congressional hearing in May endorsed requiring all newly-hired state and local workers to participate in Social Security as a way to address a portion of the program’s financial challenges.

During a May 23 hearing of the House Ways and Means Committee’s Social Security Subcommittee, G. William Hoagland, senior vice president of the Bipartisan Policy Center, said that his group’s Social Security reform plan includes mandatory Social Security coverage of all state and local employees hired after 2020.

“This proposal reflects the goal of increasing the universality of Social Security,” Hoagland said.

Ed Lorenzen, senior advisor at the Committee for a Responsible Federal Budget, meanwhile, noted that the National Commission on Fiscal Responsibility and Reform – often known as the Simpson-Bowles Commission – included universal coverage in its final report in December 2010. Lorenzen was a staff member on the commission, and he is now executive director of the Moment of Truth Project, a program created by the Committee for a Responsible Federal Budget, "to build on and continue the work" of the commission.

Although Lorenzen did not elaborate on the proposal beyond noting that it would eliminate 8 percent of the program's 75-year deficit, the commission recommended requiring all new state and local hires after 2020 to participate in Social Security, stating that, "Full coverage will simplify retirement planning and benefit coordination for workers who spend part of their career working in state and local governments, and will ensure that all workers, regardless of employer, will retire with a secure and predictable benefit check."

Neither Hoagland nor Lorenzen addressed the potential negative impact of mandatory coverage, which, according to studies by The Segal Company, could include increased taxes or cuts to essential government services to pay for the employer portion of the Social Security tax, as well as the destabilization of existing public employee retirement systems.

Subcommittee Ranking Democrat Xavier Becerra of California has consistently opposed mandatory coverage for new hires. In 2007, he was awarded the Soaring Eagle Award by the Coalition to Preserve Retirement Security – an anti-mandatory coverage group that CalPERS helped to create – in recognition of his work on this issue.

Senators Seek SGR Repeal, FFS Reform

The leaders of the Senate Finance Committee are united in their support for repealing Medicare's sustainable growth rate (SGR) formula, at least in general terms.

The SGR, which was intended by Congress to automatically set the program's physician payment rates, annually threatens to slash the federal government's payments to doctors for services provided to Medicare patients. This year, were it not for a provision included in the "fiscal cliff" deal that passed in January, payments would have been cut by 26.5 percent. The cuts are blocked for only a year, though, and the SGR calls for the rates to be reduced by 25 percent in January 2014. Congress has overridden the SGR calculations every year since 2003 in order to avoid payment cuts that, it has been feared, would drive doctors out of the Medicare program.

At a May 14 hearing, Finance Committee Chairman Max Baucus, D-Mont., said that, "It is time to repeal this broken system once and for all and end the cycle of expensive short-term fixes," and Ranking Republican Orrin Hatch of Utah said, "The SGR system is fundamentally flawed and must be repealed – we are committed to working together to do just that."

Notwithstanding that broad agreement – which is similar to sentiments that have been expressed by members of both parties in the House – lawmakers do not appear to be close to an agreement on a specific plan to replace the SGR and to pay for the transition costs, which the Congressional Budget Office has estimated will total $138 billion over the first 10 years.

Members of Congress are also looking for ways to move away from Medicare's fee-for-service (FFS) approach to payments and toward a value-based model.

"We need a system that encourages physicians to coordinate care, save money and improve health outcomes in an efficient way," Baucus said.

Mark Miller, executive director of the Medicare Payment Advisory Commission (MedPAC), told the committee that the SGR "has failed to restrain volume growth and may have exacerbated it," and that, "The FFS payment system inherently encourages volume over quality and efficiency."

"The rapid volume growth over the last decade which led to the large payment cuts required under the SGR was partially due to the underlying volume incentives in FFS reimbursement," Miller said. "New payment models, such as [accountable care organizations] and bundled payment, offer an opportunity to correct some of these undesirable incentives and have the potential to reward providers who control costs and improve quality."

Kavita Patel, fellow and managing director of The Engelberg Center for Health Care Reform at The Brookings Institution, strongly supported SGR repeal, but cautioned that, "the devil is in the details."

"Proposals to move towards new models over a period of time leave policymakers and physicians wondering what their practices will look like next month, next year and beyond," Patel said. "In moving from principle to practice, it is also important to acknowledge that while there will be no one payment model that applies to all physicians, payment models must be relevant to primary care physicians and specialists alike. Additionally, given the growing complexity of caring for Medicare beneficiaries, payment models should encourage collaborations between specialists and primary care physicians rather than focus on a model that is suited for one clinical specialty alone."

On May 10, Baucus and Hatch wrote to health care providers to ask for their assistance in crafting an SGR fix.

CalPERS signed on to an April 26 letter from two dozen groups that urged lawmakers "to permanently repeal the SGR and transition Medicare reimbursement toward a value-based system."

The letter, which was also signed by other public pension funds, insurers and advocacy groups, stated that the SGR's "ill-conceived approach to containing physician costs has repeatedly threatened to disrupt access to care" and should be reformed.

RELATED NATIONAL AND INDUSTRY NEWS

State, Local Pension Costs Average 3 Percent of Total Spending: NASRA

Pension contributions amount to just 3 percent of total spending by state and local governments, according to an issue brief released by the National Association of State Retirement Administrators (NASRA).

Using data from the U.S. Census Bureau, NASRA found that "pension costs since 1980 have been reliably stable, declining from around four percent to three percent in 2010." It noted, though, that since not all spending by states and localities is discretionary, "the actual effect of pension costs on state and city budgets is likely to be higher – to varying degrees – than calculated."

"Although pensions are not the state-local budget-drain that some claim they are … spending levels for states and cities do vary from the national average, from less than one percent to more than four percent," the brief stated. "Some municipalities have reported higher pension costs as a percentage of their budget. One study estimates that total required spending on pensions could consume as much as 13 percent of one state's budget, due partly to past failures to adequately fund pension costs and assuming a relatively low five percent investment return. The chronic failure by some pension plan sponsors to pay required contributions results in greater future contributions to make-up the difference."

Employers make just over two-thirds of annual contributions to pension plans, while employees contribute just under one-third, according to the brief, but, "The largest portion of public pension funding comes from investment earnings." NASRA also noted that many state and local employees do not participate in Social Security, so pension costs are at least somewhat offset by not having to pay Social Security taxes.

Pension contributions accounted for 3.58 percent of all state and local spending in California in 2010, according to NASRA.

Health Care Driving Long-Term Fiscal Challenges for States, Localities: GAO

State and local governments are facing a long-term revenue shortfall that is largely caused by health care expenses, according to a report from the Government Accountability Office (GAO).

Revenues are about 1 percent of GDP below expenses now, and the gap is expected to widen to about 2 percent by 2030 and about 4 percent by 2060, the GAO found.

"In the long term, the decline in the sector's operating balance is primarily driven by the rising health-related costs of state and local expenditures on Medicaid and the cost of health care compensation for state and local government employees and retirees," the report stated.

States and localities now spend 3.8 percent of GDP on health care, and that amount is expected to nearly double to 7.2 percent by 2060, even as non-health care expenses decline as a percentage of GDP. The impact of the 2010 Patient Protection and Affordable Care Act on state and local spending is "uncertain," the GAO concluded.

The report briefly noted the possible impact of pension liabilities on state and local finances, stating that, "Declines in state and local pension asset values stemming from the 2007 to 2009 economic recession could also affect the sector's long-term fiscal position."

While the combined value of pension assets increased 22 percent to $2.8 trillion between 2008 and 2011, that amount is still below the 2007 level of $3.2 trillion, the report noted.

"In our prior work, we reported that while most state and local government pension plans have assets sufficient to cover benefit payments to retirees for a decade or more, plans have experienced a growing gap between assets and liabilities," the report stated. "In response to this gap, state and local governments are taking steps to manage their pension obligations, including reducing benefits and increasing member contributions."

California Congressional Delegation News

California Senator, 5 Colleagues Back CFTC Proposal on Cross-Border Swaps

A California senator and five colleagues wrote to the Commodity Futures Trading Commission (CFTC) in May to express support for the agency's approach to cross-border swaps regulations.

The CFTC proposed rules in July 2012 to implement the requirements of the 2010 Dodd-Frank Act for futures swaps transactions that are not wholly contained in the United States. The proposal has been unpopular around the world, with many foreign groups submitting critical comments to the CFTC.

The Securities and Exchange Commission (SEC) on May 1 proposed rules and interpretive guidance for securities-based cross-border swaps that takes a somewhat less stringent approach than the one suggested by the CFTC. The SEC proposal would "generally" require compliance by parties engaged in swaps that are "entered into with a U.S. person or otherwise conducted within the U.S." However, it would allow a non-U.S. entity to abide by its home country's rules in lieu of U.S. regulations – what is known as "substituted compliance" – if "those requirements have been determined by the Commission to achieve comparable regulatory outcomes." The CFTC proposal, among other differences, appears to put stricter limits on the use of substituted compliance.

Sen. Dianne Feinstein, D-Calif., and five other Democratic senators wrote to CFTC Chairman Gary Gensler on May 22 to “express our support” for the CFTC’s proposal and urge the commission not to weaken it to match the SEC’s approach.

“Some have pointed out that the SEC – which shares jurisdiction over cross-border swap trading with the CFTC – is taking a ‘lighter touch’ regulatory approach to foreign subsidiaries in its corresponding rulemaking,” the senators stated in their letter. “The SEC’s proposed rules are inadequate to fulfill that agency’s authority and obligation, and we hope that the SEC will follow the CFTC’s model.”

A substituted compliance determination, the senators wrote, “must be made through a judicious process, on a country-by-country and requirement-by-requirement basis, and subject to a presumption that other jurisdictions do not comply unless proven otherwise.”

The SEC has stressed that its approach is “based on regulatory outcomes, not rule-by-rule comparisons.”

In addition to Feinstein, the letter was also signed by Sens. Sherrod Brown of Ohio, Carl Levin of Michigan, Tom Harkin of Iowa, Elizabeth Warren of Massachusetts, and Jeff Merkley of Oregon.