Federal Retirement Report for CalPERS Board
August 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." 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:

   Congress has been in recess for the month of August. As a result, there have been no new developments on this issue.

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:

   No recent actions as a result of the Congressional recess.

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) 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. Oppose 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:

   Congress has been in recess for the month of August. As a result, there have been no new developments on this issue.

3. Implications for CalPERS:

   Although 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 has opposed 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:

   No recent actions as a result of the Congressional recess.

5. Recommendations for Next Steps:

   CalPERS' retirement policy consultants will continue to monitor any legislation (such as the pending Miner's Protection Act, S. 1714) to prevent the inclusion of unrelated retirement provisions 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:

   Congress has been in recess for the month of August. As a result, there have been no new developments on this issue.

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:

   - On August 3, a CalPERS representative (Tom Lussier of The Lussier Group), met with members of the Association of State Retired Teacher Executives (ASRTE) in Albuquerque, NM to coordinate support for H.R. 711. The discussion focused on those changes the Chairman proposed in light of the SSA Actuary's revised analysis of H.R. 711; current efforts by public employee unions to oppose certain

provisions of H.R.711; and strategies to advance the legislation before the end of the current Congress.

- CalPERS representatives continue to communicate with Ways and Means Majority staff to discuss possible revisions to H.R. 711 to address concerns express by certain labor organizations and ongoing efforts to secure additional 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:

   - On August 24, the DOL issued a final rule on state-run savings arrangements. The final rule establishes safe harbors from ERISA for certain, state-run, payroll deduction savings programs for private sector workers. One key change from the proposed rule is that it now makes clear that the rule is in the nature of a safe harbor and, consequently, does not prohibit states from taking additional or different action or experimenting with other programs or arrangements. The rule will go into effect 60 days after publication in the Federal Register.
   - On August 24, the DOL also issued a proposed rule that would extend the state-run plan rule to political subdivisions. The proposed rule would expand the current regulation beyond states to cover programs of qualified state political subdivisions that otherwise comply with the current regulation. Under the proposed rule, a political subdivision would not be eligible to establish a plan if it is located in a state that has a state-wide retirement savings program for private sector workers. Comments on the proposed rule are due 30 days after publication in the Federal Register. *(New York City and Philadelphia are exploring the possibility of creating such plans.)*

3. Implications for CalPERS:

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

4. CalPERS/Federal Representative Actions:

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

5. Recommendations for Next Steps:

   CalPERS' federal representatives will continue to consult with CalPERS staff regarding the final rule – and the newly released proposed rule regarding expansion to political subdivisions -- and will recommend additional engagement if 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:

   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. **Puerto Rico –**

   - On August 31, the White House announced the members of seven-member federal control board, which will be in charge of restructuring Puerto Rico's debt and is required to provide adequate funding for public pensions. The members include: Arthur Gonzales, the former chief judge of the U.S. Bankruptcy Court in Manhattan, who presided over some of the most famous corporate bankruptcy cases, including Enron Corp., WorldCom Inc., and Chrysler LLC; Ana Matosantos, California's finance director from 2009 to 2013; Jose Ramon Gozalez, chief executive of the Federal Home Loan Bank of New York; Carlos Garcia, a private-equity executive who previously served as president of the Puerto Rico Government Development Bank; Jose Carion III, an insurance executive based in San Juan, Puerto Rico; Andrew Biggs, a fellow at the American Enterprise Institute in Washington; and David Skeel, a law professor at the University of Pennsylvania. Mr. Biggs is a frequent critic of public employee defined benefit pension plans.
   - On August 3, Governor Alejandro Garcia Padilla signed legislation into law that requires Puerto Rico's agencies and municipalities to pay their pension contributions before other expenses. The Puerto Rico Employees' Retirement System, the territory's largest pension system, is set to run out of funding in fiscal year 2017. The fund currently has only 0.27 percent of funds to cover $30.2 billion in retiree benefits
   - While Puerto Rico is set to increase its contributions to the pension fund, it is declining to allocate money to pay interest on its bond debt. As a result, several hedge funds holding Puerto Rico's general-obligation debt have filed a lawsuit against Governor Alejandro Garcia Padilla claiming the administration has wrongfully diverted funds in violation of the constitution.
   - PROMESA, the federal law enacted on June 30, does not establish a priority between pensioners and bondholders. The law also does not specify how the debt should be funded. Those decisions are at the discretion of the board.

- Moody's analysts point to bankruptcies in Detroit and Stockton where pensions received favorable treatment as potential examples for how the situation in Puerto Rico will unfold. Moody's calculates that bondholders in Detroit recovered 25 percent of their securities compared with 82 percent on pension liabilities.

2. **Public Pension COLA Decision -** On August 15, the Sixth Circuit upheld a Kentucky municipal pension plan's attempt to reduce the annual cost-of-living adjustment (COLA) in *Puckett v. Lexington-Fayette Urban Cty. Gov't*. The case was brought by two pensioners, a firefighter and a police officer, who claimed that the temporary reduction in their COLA benefits violated the Contract, Due Process and Takings clauses of the federal and state constitutions. Their claim was dismissed by a district judge in 2014, who found the pensioners had no contractual right to COLA benefits at specified levels. On appeal, the Sixth Circuit upheld the lower court decision, noting that only in "very limited circumstances" have courts found that state pensioners had a contractual right to specific COLA levels.

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

- **NYC Pension Returns -** New York City's five pensions are seeing the weakest investment gains in four years, according to a report released by Comptroller Scott Stringer. The funds gained 1.46 percent last fiscal year, well short of the 7 percent target. The shortfall could mean taxpayers will have to contribute an additional $732 million through 2020.

- **Chicago's Pensions** - Chicago's record property tax hike and pending agreements with city workers will help cover the $902 million the city is set to pay in 2017 pension benefits. Mayor Rahm Emanuel is projecting a deficit of $137.6 million, the smallest Chicago has seen since 2007. The budget projections take into account the tax increase passed in October to fund police and fire pensions. It also relies on state approval of an agreement reached with union leaders to keep the laborers' fund from running out of money by 2027.

  Mayor Rahm Emanuel released his proposal to increase retirement funding for the city's municipal workers pension plan, which serves over 70,000 workers. Over the last decade, the City has underfunded the plan by more than $4 billion. The Mayor's proposal calls for increased water and sewer levies. It was met with approval from the municipal market. Before the plan goes into effect, the City Council needs to approve the tax hike, and then the state must authorize the change in city and employee contributions.

- **Chicago's Bond Ratings** - Moody's officials said Chicago still has time to improve its junk investment grade, but it must reverse the direction of its mounting retirement debt in order to do so. The total of Chicago's pensions and debt is more than nine times the city's operating revenue, meaning more than 35 cents on every dollar in the budget goes to pay debt and pensions, and the city isn't making full pension payments. Chicago's current investment grade is Ba1 (Moody's). According to Naomi Richman, managing director at Moody's Investors Service, Chicago is more likely on the trajectory for a downgrade, rather than an upgrade. That being said, Richman claims Chicago is not on the brink of default.

- **NJ Supreme Court Decision on COLAs –** State employee unions and lawmakers continued to feud over whether to fully fund the New Jersey government workers' pension plan. The Senate missed the deadline to approve a proposed constitutional amendment for the November 2016 ballot. The amendment would have required the payment of full actuarially determined contributions by 2022. The Senate could still pass the measure by a simple majority vote before the session expires in January in order to place it on the November 2017 ballot. State pension funds have an $83 billion unfunded liability, which has led to higher borrowing costs and debt for the state. Over the past decade, New Jersey paid about $24 billion less than it should have into pension funds.