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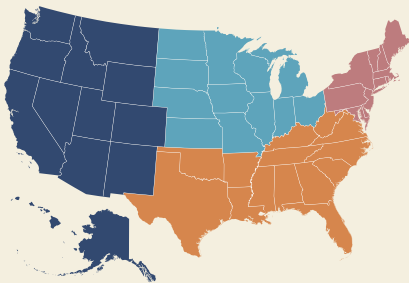
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## Retired Professor Shines Spotlight On Defined Contribution Plan Flaws



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A retired university professor has performed a very public “autopsy” of his retirement income, shedding light on how 401(k) plans are failing middle-class workers.

Writing in the May-June 2018 issue of *Academe*, James W. Russell dissected how his retirement plan fell short and why assumptions about retirement income often do not pan out, particularly for faculty members whose retirement savings are primarily in defined contribution plans. *Academe* is published by the American Association of University Professors.

Russell was instrumental in organizing a successful campaign by Connecticut workers that move their assets out of an inferior 401(k)-style plan and into the state's traditional defined benefit plan in 2012. He acted after determining that after he turned 65 in 2009, Social Security and his defined-contribution plan would have yielded only 43.5 percent of the final \$117,615 salary he had earned as a professor of sociology at Eastern Connecticut State University. A widely cited rule of thumb is that workers need to replace at least 80 percent of their income in retirement to maintain their standard of living.

The retired professor said in an interview that he dug into the issue because of “frustration at not being able to get information about actual experiences with defined contribution plans.” He said he “asked leading retirement researchers around the country if they knew of studies of actual DC experiences as opposed to predictive models or indirect indicators. No one did.”

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# Public Employee Pension Transparency Act

By Tony Roda

A few weeks ago Rep. Devin Nunes (R-CA), a senior member of the House Ways and Means Committee, began seeking cosponsors for the Public Employee Pension Transparency Act (PEPTA). This legislation has been introduced by Rep. Nunes in each Congress since 2010.

PEPTA would for the first time impose a federal reporting requirement on the funding status of state and local pension plans. The reporting requirement would be the responsibility of the plan sponsor, although most experts believe that the plans themselves will have to provide the data and analyses required under the proposal. Failure to comply with the reporting requirement would result in the loss of the plan sponsor's ability to issue bonds that are exempt from federal tax.

If enacted, the bill would require that reports be filed annually with the U.S. Secretary of the Treasury.

The reports require reporting using two distinct methods. First, pension liabilities would be reported based on the economic assumptions and rates of return that each plan currently uses as its expected return.

Second, any plan that (1) does not value its plan assets at fair market value, (2) use the U.S. Treasury spot yield curve rate to determine the value of plan liabilities or (3) determine the present value of accrued benefits by discounting its future cash flows in accordance with the Treasury spot rate and calculate as of the last day of the plan year the present value of all benefits accrued for each participant by using the unit credit funding method would have to file a supplemental report.

The supplemental report would be based, not on the plan's assumed rate of return and other assumptions, but on the assumptions described in the previous paragraph. This recalculation would result in dramatic increases in the unfunded liabilities of plans – on paper!

The first report would be required to include items a-j below. The recalculated supplemental report would contain items a-i.

**a.** A statement (determined according to the plan's funding method) of the plan liability, the value of plan assets, the amount by which (if any) the plan liability exceeds the value of plan assets and the funding percentage of the plan.



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- b.** A schedule of all contributions by the plan sponsor for the plan year that indicates which contributions are taken into account under subparagraph (a).
- c.** Projections for each of the 60 subsequent plan years of the cash flows associated with the plan liability.
- d.** A statement of the actuarial assumptions used for the plan year, including the rate of return on investment of plan assets and assumptions as to such other matters as the Secretary of the Treasury may prescribe by regulation.
- e.** The number of each of the following types of participant:
  - i.** Separated from service and receiving benefits.
  - ii.** Not described in clause (i), separated from service, and entitled to future benefits.
  - iii.** Accruing and receiving benefits.
  - iv.** Not described in clause (iii) and accruing benefits.
- f.** A statement of the plan's investment returns (including the rate of return) for the plan year and the five preceding plan years.
- g.** Pursuant to such regulations as the Secretary shall prescribe, an explanation of the plan's funding policy, and a statement of the degree to which, and manner in which, the plan sponsor expects to eliminate any unfunded plan liability for the plan year and the extent to which the plan sponsor has followed the plan's funding policy for each of the preceding plan five years.
- h.** A statement of the amount of any pension obligation bonds outstanding.
- i.** A statement of the current cost of the plan for the plan year determined according to the plan's funding method.
- j.** A statement of the plan's administrative and investment expenses.

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## RETIRED PROFESSOR CONTINUED FROM PAGE 1

He felt compelled to share his experience after realizing how close he had come to being unable to cover his costs in his golden years.

“I had been given a supposedly irrevocable choice in 1986, when I had first taken a position at Eastern Connecticut State University,” Russell wrote. He could continue the TIAA plan he had from previous universities or join the state pension plan. He said his assumption that the two plans would be roughly equivalent was “the biggest financial mistake of my life.”

Russell, who worked in academia for 37 years, said he analyzed a lifetime’s worth of defined-contribution plan statements to understand why his retirement income fell short. Over the years, his employers contributed 8 percent to the plan and he contributed 5 percent, for a total of 13 percent, and averaged a 7.1 percent annual return. His accumulated retirement assets were nearly \$500,000 in 2009.

He intended to place his defined-contribution portfolio into a lifetime annuity upon retirement. But the end of 2009, when he was 65, proved to be a particularly bad time to retire because of the impact of the 2008 Great Recession.

He noted that he was poised to come up short after years of saving despite having a higher than average savings rate and respectable investment returns. “I concluded that the individual retirement savings model itself was at the root of the problem since it lacks the risk sharing advantages of the DB model,” he said in an interview. The options for Russell in 2009 did not look good. He decided he would have to work till age 70 to maximize his Social Security benefits and accumulate more savings. He noted that this was

possibly only because he was healthy and didn’t have a strenuous job. But even working to 70 would not be sufficient – he would have had to work until age 73 to accumulate enough to retire at a 70 percent replacement rate, provided the stock market cooperated.

Instead, Russell organized what became a four-year campaign to include university professors who had chosen a supposedly superior defined-contribution option to transfer into the state’s defined-benefit plan.

“It was not easy,” Russell wrote. “It required educating and mobilizing members of a number of different state-employee unions.”

In the end, Connecticut allowed workers on a voluntary basis to transfer to the state pension plan and use their accumulations in the defined-contribution plan to purchase credit for time served. “The rollover raised my employer-plan replacement rate from 24 to 46.4 percent, much better than if I had left it in the defined-contribution plan. The total replacement rate went from 49.6 to 76.2 percent, and I was able to retire.”

At a time when many employees are being forced out of defined-benefit pension plans and into 401(k)s, fighting for better choices is an option, Russell wrote. The decision he made in 1986 “was a loaded choice that formed part of the basis for a union grievance that we filed and won, paving the path to the solution of being able to change to the much better pension system. It was well worth the effort in terms of retirement-income payoff.” Public employees in Connecticut, Massachusetts, Florida and West Virginia have fought and won the right to transfer from defined-contribution to defined-benefit plans, he noted. ♦

# 2018 PUBLIC PENSION FUNDING FORUM

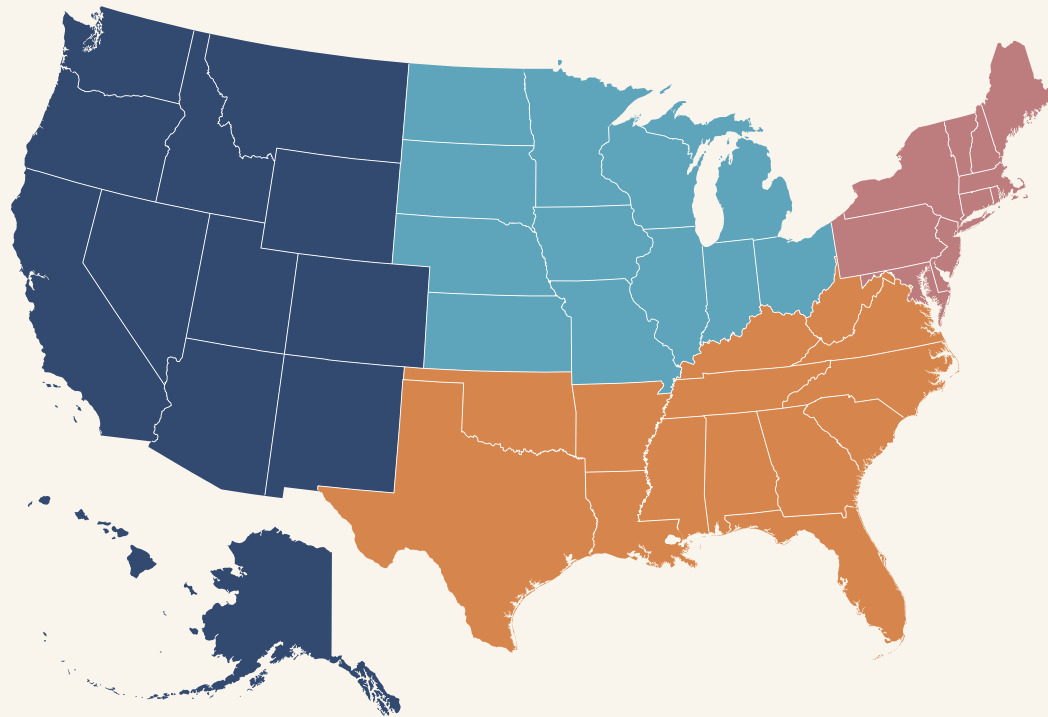
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This month we highlight a Supreme Court case in Rhode Island, Minnesota's public pension reform, CalSavers, and an ongoing Supreme Court case in Texas.



## NORTHEAST: Rhode Island



The Supreme Court of Rhode Island on May 25 dismissed a bid by 140 state retirees to restore pension benefit cuts that were enacted in 2011 and affirmed in 2015 under a class action settlement.

The ruling by Justice Gilbert Indeglia upheld the 2015 class action as “fair, reasonable, and adequate.” The Justice concluded that the suspension of annual cost-of-living adjustments (COLAs) under the 2011 law was offset by “concrete and immediate benefits’ from the settlement, including a more favorable COLA formula, two \$500 stipends paid to retirees, and a calculation that would reduce the minimum retirement age for employees.”

Lawmakers in 2011 had argued that the COLA cuts, which affected 60,000 current and future retirees, were needed to save taxpayers approximately \$4 billion in unfunded pension liabilities. The law increased the minimum retirement age, suspended COLAs, and moved workers into a hybrid system that combined a reduced defined benefit plan with a defined contribution plan.

Public employee unions sued after the law was enacted, arguing that COLAs were contractual promises that the state had broken. Most public unions went along with the 2015 settlement, but a group of retirees broke away to fight the benefits reductions.

“Obviously, I’m certainly disappointed by the results. I’m very disappointed for my clients and for state retirees,” said Thomas Dickinson, who argued before the Supreme Court on behalf of about 70 retired state employees, told the *Providence Journal*.

The retirees who objected to the ruling, many now in their 70s, had argued that the judge who approved the 2015 settlement should not have incorporated them into the class-action lawsuit with other union employees because they constituted a distinct group. However, the judge found – and the Supreme Court agreed – that their claims were similar to those raised initially by the unions and that they had received adequate notice of the settlement.

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## MIDWEST: Minnesota



After three years of wrangling, bipartisan supporters rallied behind Minnesota's public pension reform bill, which Governor Mark Dayton signed into law May 31.

The changes that passed will immediately eliminate \$3.4 billion in unfunded liabilities and should put Minnesota pension plans on a more stable path for the future. The state will contribute \$141 million to pension plans over the next few years. Meanwhile, retirees agreed to some benefit reductions and current workers must increase their contributions to the pension funds. Minnesota's pensions serve 500,000 people.

"We worked to introduce legislation over the last the years, but the bills were vetoed" by Governor Dayton because of controversy, said Erin Leonard, executive director of the Minnesota State Retirement System. For example, last year the governor vetoed the bill over a measure that would have pre-empted cities from setting policies for wages and working conditions.

This time, Leonard said, the bill included sufficient shared sacrifice to strengthen support, and it was passed unanimously by both the House and Senate. The final reforms will have an impact on "the choice of plan, not core benefits," she said, adding "All the stakeholders of the plan were supportive."

Dayton, a member of the Democratic-Farmer-Labor Party, said he had been contacted by retirees and active employees who stressed "how vitally important this is for their peace of mind, for their financial security, for their sense of being able to rely on pensions, on the promise that they've earned," according to news reports.

Minnesota has \$16.2 billion future debt for its public pensions, and credit rating agencies had warned state budget officials that unfunded liabilities needed to be tamed. The change is a shared sacrifice between employees, employers and retirees, Minnesota Management and Budget Commissioner Myron Frans said, according to the *Star-Tribune*.

## WEST: California



California's treasurer is not backing down in the face of an attack on the CalSavers Retirement Savings Program by an extreme anti-tax group.

CalSavers, the state's new program to encourage retirement savings by private-sector workers, remains on track to begin a three-year rollout in the coming months, according to California State Treasurer John Chiang. Chiang chairs the California SecureChoice Retirement Savings Investment Board, which oversees the CalSavers program.

"We remain confident that we are on strong legal ground," Chiang said. He said the state is "undaunted, undistracted, and unwavering in our commitment to successfully launch a bold, innovative program."

The Howard Jarvis Taxpayers Association filed a complaint May 31 in the U.S. District Court in Sacramento, arguing that the state law creating CalSavers is pre-empted by the Employee Retirement Income Security Act (ERISA). The association demanded a permanent halt to the program to prevent state officials "from wasting taxpayer funds by further implementing CalSavers," the complaint said.

California in September 2016 became the largest state to enact legislation creating a state-facilitated retirement savings program for private sector worker. California's Secure Choice program was designed to provide a path to retirement security for millions of Californians who lacked access to work place retirement benefits – 7.5 million people by the state's latest estimates.

The program imposes no costs or liabilities on taxpayers. Instead, the program sustains itself through participant fees. The state will have no liability for the program funding or performance

The California Secure Choice Retirement Savings Investment Board is developing and implementing CalSavers and anticipates initiating a pilot program in late 2018. The program would be officially open for statewide enrollment in 2019, according to its website.

CONTINUED ON PAGE 8



## US, Canadian Pension Systems Advocate for SEC Transaction Fee Pilot

North American public pension systems have come together in a strong show of support for the Securities and Exchange Commission's proposed pilot program to reduce complexity in stock trading.

Nineteen organizations, spearheaded by the Ontario Teachers' Pension Plan and the California Public Employees' Retirement System (CalPERS), urged the SEC to proceed with its Transaction Fee Pilot for National Market System stocks. NCPERS has been pleased to help facilitate the push, which harnesses the collective influence of U.S. and Canadian pension systems representing 7 million members and \$1.4 trillion in assets.

In a letter to the SEC, the organizations said long-term investors like public pension plans are bearing the cost of changes in market structure that are occurring due to technological advancements and regulatory rulemaking. In particular, they pointed to stock exchanges' practice of paying rebates to broker members for order flow, also known as maker-taker or taker-maker pricing. These pricing schemes and other fee incentives create a potential conflict of interest between brokers and their investor clients, the organizations said.

The SEC's Transaction Fee Pilot would be "a necessary and appropriate step to study the effects that these incentives have on broker order routing, execution quality, and market quality overall," said the pension organizations' letter.

SEC Chairman Jay Clayton said the pilot, which he proposed in March, should help the SEC better understand the effects of these issues, and ultimately to make "more informed and effective policy decisions in the future, all to the benefit of retail investors."



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*The SEC's Transaction Fee Pilot would be "a necessary and appropriate step to study the effects that these incentives have on broker order routing, execution quality, and market quality overall."*

The letter also called on the SEC to test the elimination of exchange rebates by including a test group that "prohibits the payment of rebates to create a data set that demonstrates the effect of rebates, of any size, on order routing and executing quality. Without this test group, the Pilot will be of limited use to long-term investors

who question the importance of rebates to overall market quality."

The pension organizations said they favor including the widest-possible range of National Market System stocks in the pilot, and of conducting the pilot over two years. They also said companies should not be allowed to opt out of the pilot.

The letter was signed by Kevin Duggan, a managing director of the Ontario Teachers' Pension Plan and Don W. Pontes, an investment director of CalPERS.

[CONTINUED ON PAGE 7](#)

A complete list of the signatories to the letter follows:

- |  |  |
|--|--|
| Alaska Permanent Fund Corporation                            | New York City Employees' Retirement System         |
| Alberta Investment Management Corp.                          | New York City Fire Pension Plan                    |
| Arizona State Retirement System                              | New York City Police Pension Fund                  |
| Board of Education Retirement System of the City of New York | Ontario Teachers Pension Plan                      |
| California Public Employees' Retirement System               | San Diego City Employees' Retirement System        |
| California State Teachers Retirement System                  | San Francisco Employees Retirement System          |
| HOOPP – Healthcare of Ontario Pension Plan                   | State of Wisconsin Investment Board                |
| Illinois Public Pension Fund Association                     | Teachers Retirement System of the City of New York |
| National Conference on Public Employee Retirement Systems    | Vestcor Investment Management Corporation          |
|  | Wyoming Retirement System                          |

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Finally, the legislation states that the federal government shall not be liable for any obligation of a state or local retirement plan and that the Act shall not be construed to require the federal government or Federal Reserve to provide financial assistance to any such plan.

NCPERS has opposed PEPTA since its first introduction and continues to do so. NCPERS believes that:

- Reporting based on the Treasury spot yield curve rate would conflict with the current standards set by the Governmental Accounting Standards Board (GASB), increase costs on plans sponsors (state and local governments) and plans, and undermine investor confidence in the municipal bond market.
- Reporting based on the Treasury spot rate would result in projected economic returns that are unrealistic when compared to the diverse investments contained in pension plan portfolios. A pension plan would have to be invested 100 percent in Treasury bonds for the yield curve calculation to have any real world significance.
- Inaccurate descriptions of the funding levels of public pension plans would confuse plan participants, retirees, legislators and the public.

- PEPTA would be a harmful precedent for federal intervention into areas that are the financial responsibility of and historically have been regulated by states and localities.
- Since the Great Recession, states and localities have aggressively moved to modify their pension obligations to improve and enhance pension sustainability over the long term.
- The legislation is unwarranted. State and local governments are not seeking a federal bailout.
- Please be assured that NCPERS will be working over the next few months to educate Members of Congress and the Trump Administration on the shortcomings of PEPTA and will work against its inclusion in any federal legislation. ♦

*Tony Roda is a partner at the Washington, D.C. law and lobbying firm Williams & Jensen, where he specializes in legislative and regulatory issues affecting state and local pension plans. He represents NCPERS and state-wide, county and municipal pension plans in California, Ohio, Tennessee and Texas.*

## SOUTH: Texas



The Supreme Court of Texas on June 1 agreed to review a case that challenges a Dallas pension plan's decision to cut the future interest rate on its deferred retirement option plan, or DROP.

The question before the court is to what degree Texas' constitution protects public employee pensions from cutbacks. A date for oral arguments had not yet been set at press time.

The case pits a group of Dallas police officers and firefighters against the Dallas Police and Fire Pension System. Four police officers and firefighters sued the pension system in 2014, maintaining that its decision that year to reduce the DROP interest rate it uses to calculate future interest accruals violated a 2003 amendment to the Texas constitution. The 116th District Court in Dallas found

in favor of the pension system after a 2014 trial, and the state's Fifth Court of Appeals in 2016 upheld the lower court's ruling.

The case, Eddington et al. vs. Dallas Police and Fire Pension System, arose after the pension system board in 2014 approved a plan to gradually reduce, from 8 percent to 5 percent by 2017, the interest rate used to accrue interest under DROP. When the board approved the plan in 2014, 8 of its 12 members were active or retired police officers and firefighters.

The police officers and firefighter plaintiffs argued that DROP and the interest rate used to calculate it were constitutionally protected benefits. They cited Section 66 of the state constitution, which was amended in 2003 to stipulate that certain benefits under certain local public retirement systems could not be reduced or impaired. The pension system countered that the amendment only protected accrued benefits, not future, unearned benefits.

In its ruling, the Fifth Court of Appeals found that the state constitution allows Texas to maintain its "long held flexible approach permitting municipalities to revise their pension plans in light of changing economic conditions," provided they don't tamper with accrued benefits. ♦





## 2018 Conferences

### September

#### Public Pension Funding Forum

September 10 – 12  
Cambridge, MA

### October

#### NCPERS Accredited Fiduciary Program (All modules)

October 27 – 28  
Las Vegas, NV

#### Public Safety Conference

October 27 – 31  
Las Vegas, NV

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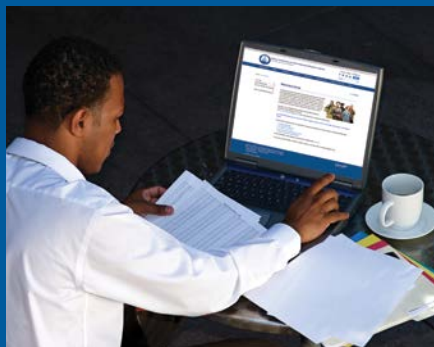
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