

TEACHERS' RETIREMENT BOARD

REGULAR MEETING

SUBJECT: Federal Legislation Update

ITEM NUMBER: 5

CONSENT:

ATTACHMENT(S): 1

ACTION:

MEETING DATE: November 6, 2008 / 45 mins.

INFORMATION: X

PRESENTER: Ed Derman /
John Stanton, Hogan and Hartson

PURPOSE OF THIS ITEM

This item provides an opportunity for the Board to discuss potential federal activities concerning financial markets, as well as a summary of federal activities that affect CalSTRS and its members.

RELATIONSHIP TO THE BOARD'S STRATEGIC PLAN

Goal 6	Foster Board culture and practices that promote efficient and effective governance.
Objective B	Continually improve information supplied to the Board for its decision making by staff and outside service providers so that is organized, concise and useful.

EXECUTIVE SUMMARY

At the request of the Board, John Stanton of Hogan and Hartson LLP, CalSTRS' Washington counsel, will present to the Board his perspective on legislative and regulatory issues associated with the recent financial market turmoil.

In addition, for each Board meeting, Mr. Stanton prepares a Washington Monthly Report that updates recent activities in Washington, D.C. A copy of his latest report is attached.

This month's report includes information on:

• **Emergency Economic Stabilization Act**

The Stabilization Act provides the Treasury Secretary with broad authority to purchase and guarantee "troubled assets", which include not only mortgages and securities based on mortgages, but extend also to "any other financial instrument" that the Secretary, in consultation with the Chairman of the Federal Reserve, "determines the purchase of which is necessary to promote financial market stability." Such authority by the Treasury Secretary includes "protecting the retirement security of Americans by purchasing troubled assets held by or on

behalf of an eligible retirement plan including defined benefit, defined contribution, section 403(b), and section 457 plans.”

- **IRS Continues Its March Toward Public Plans**

The IRS’s plan to closely scrutinize the Federal tax compliance of State and local government retirement plans continues to be very controversial, drawing the wary attention of public plan groups and public employer and employee groups, as well as concern among the Congressional tax-writers on Capitol Hill. While the IRS has declared itself in need of education about the plans’ structure and operation, the IRS continues to spurn repeated offers by the national groups representing State and local plans, employers, and employees to sit down at a meeting to provide such information on a 50 State basis and to discuss the unique characteristics of public plans and the tailored Federal tax rules that have been necessary to accommodate such unique government plans. Under the IRS’s current approach, a questionnaire would first be sent to an initial sample of 20 to 30 randomly selected State and local plans. Based on the results from this initial sample, the questionnaire will be refined, and a more comprehensive questionnaire will be distributed more broadly to some 200 public plans during the first part of 2009. The IRS has threatened that failure by a plan to respond to the questionnaire would give rise to a compliance check by the IRS of the plan’s adherence to the Federal tax qualification requirements.

- **American Academy of Actuaries Defers Liabilities Issue to Actuarial Standards Board**

Proponents of “financial economics” are calling for a significant change in the manner in which the liabilities of public retirement plans should be calculated and disclosed. Under current actuarial practice, the expected rate of return on the investment of the plan assets serves as the basis of the discount rate used in measuring the plan’s liabilities for benefits. The “financial economics” advocates assert that instead of calculating the plan’s liabilities on the basis of the expected return over time from the plan’s diversified investment portfolio, the liabilities should be measured and reported on a “market value liability” (MVL) basis utilizing a “risk-free” rate of assumed investment return and mark-to-market accounting. Critics of the MVL approach have countered that use of an artificial risk-free measure – which had its origin in projecting liabilities in the event of plan termination in the private sector – is not an appropriate measure for an ongoing governmental plan and could result in an artificially high level of liabilities. Some public plan actuaries have estimated that application of the MVL approach could increase a public plan’s reported liabilities by as much as 15 percent. The American Academy of Actuaries has decided to defer the entire issue to the Actuarial Standards Board for a resolution of how to calculate plan liabilities.

- **HELPS II Legislation to Provide a \$3,000 Deduction for Health Coverage for State and Local Retirees.**

The National Conference on Public Employee Retirement Systems (NCPERS), which promoted the original HELPS legislation for public safety workers, was unable to find a Congressional sponsor to introduce the HELPS II measure before Congress adjourned. The draft legislation known as “HELPS II” would provide a tax deduction of up to \$3,000 for health insurance premiums paid by a State and local government retiree. The draft legislation would provide survivor benefits by extending the deduction to surviving spouses of State and local retirees. Renewed efforts by advocacy groups to promote this type tax deduction are expected.

- **Social Security Reform -- GPO and WEP Offsets**

Congress adjourned without taking action on the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP). The controversial issue of Social Security reform, along with reform of the offsets, and the equally nettlesome issue of Medicare solvency will be left for the new Administration and the new Congress.

- **Federal Pension Legislation and Regulation**

- The Senate left town without completing action on a package of pension technical corrections passed earlier by the House that includes a provision to prevent State and local defined benefit plans from being swept up into rules aimed at curbing abuses in the context of cash balance conversions in the private sector.
- Wide-ranging legislation to require greater transparency of section 401(k) investment and management fees and disclosure of potential conflicts of interest by plan consultants, has died in the House.

- **Initiatives of Interest to CalSTRS as Investor**

- The multilateral effort to “regulate” sovereign wealth funds led by the International Monetary Fund (IMF) has succeeded in its effort to reach agreement with sovereign wealth funds on a set of voluntary best practices. The two dozen principles, known as the “Santiago Principles” after the meeting place where they were hashed out, were officially announced by the IMF on October 11. In brief, this voluntary code of conduct would require the sovereign wealth fund to have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability.
- Legislation to facilitate divestment of holdings in businesses dealing with Iran’s energy industry died on the Senate Floor as Congress adjourned.
- Congress kicked off serious debate on bipartisan legislation to control carbon dioxide emissions. While no one expected final enactment of such legislation this year, the Congressional debate was seen as setting the stage and framing the issues for serious consideration next year.
- (H.R. 1257), spearheaded by House Financial Services Committee Chairman Barney Frank (D-Mass.), to provide shareholders of publicly-traded companies with an

advisory vote on executive compensation died a quiet death in the Senate amid GOP objections, the “say on pay” concept enjoyed a brief resurgence in the context of the financial bail-out legislation.

- A U.S. General Accountability Office study completed in late August found increasing levels of investments by private pension plans in hedge funds and private equity funds.

- **Study Calculates that DB Plans Provide Retirement Benefits at Half the Cost of DC Individual Account Plans**

Defined benefit pension plans can deliver the same level of retirement benefit at a 46 percent lower cost than a defined contribution individual account plan, according to a recent study by the National Institute on Retirement Security. The study, released in August, is entitled “A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans”.

- **Elk Hills**

The stream of Elk Hills compensation that thus far has produced a total of \$300 million in Elk Hills compensation began in FY 1999. It is hoped that with a new Administration, a resolution will emerge soon of the pending litigation between the Federal Government and Chevron over the Department of Energy’s alleged misconduct in the process used to determine the proper equity split of the proceeds from the Elk Hills sale. Since CalSTRS shares in the Federal Government’s piece of the sales proceeds, we are left to further await the resolution of this dispute in order to move forward on the last installment of Elk Hills compensation that could exceed \$20 million. This last installment would boost CalSTRS’ total Elk Hills compensation to more than \$325 million.

HOGAN &
HARTSON

**MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

Washington Monthly Report

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Federal Financial Bailout Legislation

As trillions melt away in retirement accounts across the country, we are reminded of Adlai Stevenson's observation after his defeat in the battle for the Presidency that, "it hurts too much to laugh, and I am too old to cry." Anything we say here will become outdated as soon as written, as Treasury and the Federal Reserve leap about dealing with the *crisis du jour* in seeking to unlock the U.S. credit markets and the world financial system more generally.

The Emergency Economic Stabilization Act – the formal name for the financial bailout legislation – provides the Treasury Secretary with broad authority to purchase and guarantee "troubled assets", which include not only mortgages and securities based on mortgages, but extend also to "any other financial instrument" that the Secretary, in consultation with the Fed Chairman, "determines the purchase of which is necessary to promote financial market stability. . . ." The Secretary also is given authority to make capital injections into financial institutions in return for preferred equity.

In exercising his broad authority, the Treasury Secretary is supposed to give attention to a laundry list of precatory "considerations" enumerated in the legislation, including "protecting the retirement security of Americans by purchasing troubled assets held by or on behalf of an eligible retirement plan [defined to include defined benefit, defined contribution, section 403(b), and section 457 plans]."

IRS Continues Its March Toward Public Plans

The IRS's plan to closely scrutinize the Federal tax compliance of State and local government retirement plans continues to be very controversial, drawing the wary attention of public plan groups and public employer and employee groups, as well as concern among the Congressional tax-writers on Capitol Hill.

Contributing to the wariness of the public plan community has been a lack of transparency on the part of the IRS. While the IRS has declared itself in need of education about the plans' structure and operation, the IRS continues to spurn repeated offers by the national groups representing State and local plans, employers, and employees to sit down at a meeting to provide such information on a 50 State basis and to discuss the unique characteristics of public plans and the tailored Federal tax rules that have been necessary to accommodate such uniquenesses.

Instead, the IRS's new public plan effort is being led by its enforcement division and would take the form of a questionnaire directed at State and local plans, backed up by the threat of a follow-up tax compliance check by the IRS. Veteran observers of bureaucracy will recognize that the seriousness of the IRS's resolve here is manifested by the fact that this effort has now been given a name, the "Governmental Plan Initiative", and thus its own separate, continuing identity.

The IRS's stated purpose is to learn more about public plans and the issues raised by such plans, rather than to unearth errors committed by the plan. Under the IRS's current approach, the questionnaire would first be sent to an initial sample of 20-30 randomly selected

State and local plans. Based on the results from this initial sample, the questionnaire will be refined, and a more comprehensive questionnaire will be distributed more broadly to some 200 public plans during the first part of 2009. The IRS has threatened that failure by a plan to respond to the questionnaire would give rise to a compliance check by the IRS of the plan's adherence to the Federal tax qualification requirements.

The public plan community is very concerned about this IRS questionnaire exercise because governmental plans have many unique characteristics, which in turn are reflected in a spate of special Federal tax rules for public plans that are tailored to such uniquenesses. The terms of the State plans are creatures of State law adopted by the legislature and overseen by a board of elected officials and representatives of labor and the stakeholder community which takes its fiduciary responsibilities under State law seriously. The public plan community is wary that the admittedly ill-informed IRS, which is undertaking the questionnaire effort through its enforcement division not its policy or technical branches, will view everything through the private plan prism of rules aimed at preventing employer manipulation of the plan because in the private sector the employer controls the plan and hence "is the plan" and will use their usual tools of threats rather than cooperation.

The IRS's initial dealings with the public plan community on the questionnaire exercise have not engendered trust. Initial drafts of the questionnaire ventured far beyond the IRS's jurisdiction over public plans, requiring information about plan governance, funding, investment of plan assets, and benefit accruals – all relating provisions under ERISA and the Internal Revenue Code from which State and local plans are expressly exempted by Congress. Even those questions that aimed at relevant areas were framed using the prism of private sector rules, such as what is the "plan document", where is it kept, and how does the plan communicate with its members.

In the wake of the lack of transparency in the IRS process, the overbroad nature of its questionnaire, the IRS's rush to get the questionnaire out the door to the initial sample of plans in July, and the IRS's evident unwillingness to have a dialogue with the national groups of State and local plans, the groups alerted the House and Senate tax-writing committees which have jurisdiction over public plans on Capitol Hill. This led to the House Ways and Means Committee will be convening its own "roundtable" on September 19 with key Members of Congress, senior IRS staff, General Accountability Office (GAO) staff, and representatives of public plan groups to discuss the issues and concerns related to the IRS's questionnaire and intensified scrutiny of State and local plans. The public plan groups included representatives of State and local plans (NCTR, NASRA, and NCPERS), employer groups (NCSL, GFOA), and employee groups (AFT, United Federation of Teachers of New York City, and firefighters).

We were invited to attend by House Ways and Means Chairman Charles Rangel (D-N.Y.), who sent a letter after the meeting expressing appreciation for our participation. (See letter from Chairman Rangel and Rep. Pomeroy attached).

The House Ways and Means Roundtable was chaired by Rep. Earl Pomeroy (D-N.D.), a former State Insurance Commissioner, who has assumed the mantle of pension expert on the Ways and Means Committee. He has a longstanding working relationship with Jack Ehnes and recently came out to the CalSTRS offices for an informal briefing on Federal and

investment issues of interest to CalSTRS. At the Ways and Means Roundtable, we had several opportunities to chat with Rep. Pomeroy. He was very complimentary about Jack and welcomes the CalSTRS input very much.

Rep. Pomeroy did a very effective job of running the Ways and Means Roundtable with the imprimatur of Chairman Rangel, who called in briefly from New York to emphasize to the group -- most particularly Treasury and the IRS -- that Rep. Pomeroy was operating on this issue and at this meeting with the Chairman's proxy. The various public plan speakers effectively laid out the views of the public community, particularly Dana Bilyeu from the Nevada system and Nancy Kopp, the Treasurer of Maryland who sits on the board of the Maryland system. The key part of the public plan presentation was to emphasize the broad ranging regulation, transparency, and accountability that already exists at the State level, as well as the fact that IRS guidance is still needed on a variety of fronts to tailor the generic private plan rules to the unique characteristics of public plans before the IRS turns its attention to enforcement and auditing compliance. The public plan group, with the active support of Rep. Pomeroy, extended the olive branch by calling for a collaborative process with the IRS here.

For its part, the IRS nodded a lot at our talk of collaboration, but at the end of the day was unrepentant. This was, after all, the enforcement branch of the IRS. Policy, providing guidance -- that responsibility fell to other branches at the IRS and Treasury. (Interestingly, the chief pension staffer at Treasury expressly disclaimed any authorship, involvement, or responsibility for the IRS's Governmental Plan Initiative, noting that such initiative was solely the province of the IRS enforcement division, not the Treasury policy office.) Notwithstanding nearly two hours of cajoling to work collaboratively with the public plan community, the leader of the IRS Team, the Commissioner for the Tax Exempt and Government Entities Branch of the IRS Steve Miller, said flatly to Rep. Pomeroy and our group that "I'm not making any promise to vet it [the questionnaire] one more time before I send it out" to the government plans. Both Rep. Pomeroy and Chairman Rangel's staff were moved to respond that they hoped they did not have to report back to Chairman Rangel that because of the IRS's unrelenting stance, the Roundtable effort had been a failure. Indeed, in our 28 years of lobbying the Congress we cannot remember as pointed an exchange as that when Rep. Pomeroy then turned to Commissioner Miller and warned, "There will come a time, Mr. Miller, when you will have to come back to appear before the Ways and Means Committee in the future, and I will be up on the dais."

Rep. Pomeroy asked the IRS to consider discussing the questionnaire contents with a small working group of NASRA, NCTR, and NCPERS representatives, with the working group being given 2 weeks to provide feedback. The public plan community is awaiting reaction from the IRS. We will continue to coordinate with NCTR, NASRA, and the other public plan groups to closely monitor IRS and Congressional developments on this front.

***MVL Disclosure for Public Plans –
American Academy of Actuaries Punts to the Actuarial Standards Board to Figure It All Out;
GASB Opens a Parallel Front on MVL for Financial Reporting Purposes***

Faced with a deep rift among its members over whether and how the “financial economics/market value of liabilities” disclosure concept should be applied to public plans, the American Academy of Actuaries (AAA) has decided to punt the entire issue to the Actuarial Standards Board (ASB) to figure out.

By way of background, the proponents of “financial economics” are calling for a significant change in the manner in which the liabilities of public retirement plans should be calculated and disclosed. Under current actuarial practice, the expected rate of return on the investment of the plan assets serves as the basis of the discount rate used in measuring the plan’s liabilities for benefits. The “financial economics” advocates assert that instead of calculating the plan’s liabilities on the basis of the expected return over time from the plan’s diversified investment portfolio, the liabilities should be measured and reported on a “market value” (MVL) basis utilizing a “risk-free” rate of assumed investment return and mark-to-market accounting.

Critics of the MVL approach have countered that use of an artificial risk-free measure – which had its origin in projecting liabilities in the event of plan termination in the private sector – is not an appropriate measure for an ongoing governmental plan and could result in an artificially high level of liabilities. Some public plan actuaries have estimated that application of the MVL approach could increase a public plan’s reported liabilities by as much as 15 percent. This artificial measure of liabilities, it is feared, would result in an artificially constraint on asset allocations and investment returns, stunting the plan’s investment performance.

AAA’s Public Interest Committee held a “forum” on September 4 to hear from both sides in this debate. Written comments were limited to three pages, and requests to testify by the National Council on Teacher Retirement and the National Association of State Retirement Administrators were rejected. No plan administrator was invited to testify. The usual suspects testified from the MVL side. Their leading argument according to the Public Interest Committee’s written summation of the forum was: “There is a disconnect between the economic value of a stream of payment [sic.] generally accepted by economists and taught to first-year MBA students and the present value of the same stream of payments determined by actuaries using the expected rate of return on assets that may be used to pay such benefits.” Evidently, when in doubt on real world actuarial science, turn to the first-year MBA curriculum for guidance.

Opponents of MVL were equally vociferous. AAA’s Public Plan Subcommittee voted 13 to 2 against disclosure of MVL and argued that MVL’s relevance to public plans had not been publicly developed. A petition signed by 177 AAA members was filed in opposition to use of MVL for public plans. AAA’s Public Plan Subcommittee argued that a statement of opinion by AAA on the public plan MVL disclosure issue would be construed by the actuarial community as imposition by AAA of a standard of practice, without adhering to the standard-setting process. Rather, the Actuarial Standards Board was the proper body to be reviewing the issue, not AAA. In addition, following an informal briefing on the MVL issue during his on-site

visit to CalSTRS, Rep. Pomeroy, who as a former State Insurance Commissioner has a quick appreciation for these types of issues, sent a strong letter of concern to AAA about adoption of MVL for public plans. (See Rep. Pomeroy letter attached.)

At the end of the day, AAA decided to punt the issue to ASB, but not before the AAA's Public Interest Committee added its own two cents in favor of MVL disclosure for public plans. The Committee's report stated there was consensus within the Committee that "developing and disclosing a consistent measure of the economic value of retirement plan assets and liabilities is in the public interest, but because of a lack of agreement on how a consistent measure of economic value for public pension plans should be determined, and the desire to make sure the profession 'gets the science right.'" Accordingly, the Committee's recommendation, adopted by the AAA Board, was that AAA charge the Actuarial Standards Board with "consideration, development, and adoption of appropriate standards of actuarial practice to address this issue." The Committee further recommended that "[i]n light of both the polarity of the membership on this issue and some of the concerns expressed. . .the Academy should not issue a public statement at this time, but instead should encourage the Actuarial Standards Board to expeditiously consider this issue and draft an appropriate standard of practice addressing this issue." Let's leave it to the other guy to "get the science right", but oh by the way we "believe it is the public interest for retirement plans to disclose consistent measures of the economic value of plan assets and liabilities in order to provide the benefits promised by plan sponsors."

As reported last month, this proselytizing of the financial economics/MVL contingent is beginning to make inroads into the financial reporting community, as well as on the actuarial front. The Government Accounting Standards Board (GASB) is in the process of revisiting two key sets of accounting rules affecting State and local retirement plans – GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and No. 27, *Accounting for Pensions by State and Local Governmental Employers* – and already has signaled that consideration of the MVL disclosure issue will be part of this process.

We will continue to coordinate with NCTR and NASRA as well as tracking developments on this front.

"HELPS II" Legislation to Provide a \$3,000 Deduction for Health Coverage for State and Local Retirees

The National Conference on Public Employee Retirement Systems (NCPERS), which promoted the original HELPS legislation for public safety workers, was unable to find a Congressional sponsor introduce the HELPS II measure before Congress adjourned. The draft legislation known as "HELPS II" would provide a tax deduction of up to \$3,000 for health insurance premiums paid by a State and local government retiree. The draft legislation would provide survivor benefits by extending the deduction to surviving spouses of State and local retirees. The proponents of the HELPS II legislation are expected to make a renewed effort in the new Congress, and we will continue to coordinate with the National Council on Teacher Retirement (NCTR), the National Association of State Retirement Administrators (NASRA), and NCPERS with respect to this legislation.

Health care reform more generally is expected to receive prominent attention next year with a new Administration and a new Congress, particularly under an Obama Administration which has made health reform its top legislative agenda item before the House Ways and Means and Senate Finance Committees. Senior Congressional staff recently indicated that key areas of the health care reform debate will include whether the current tax-free nature of employer-provided health insurance should be changed and if so how; whether to adopt a “play or pay” mandate for employers to provide health insurance; and whether some form of government operated plan should be used for those unable to receive health coverage through employers. If only there will be any money left in the Federal Treasury when Congressional attention turns to the issue. We will be following these events closely, watching for legislative opportunities for initiatives to assist CalSTRS retirees in obtaining affordable health care coverage.

Social Security Reform -- GPO and WEP Offsets

Congress adjourned without taking action on the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP). The controversial issue of Social Security reform, along with reform of the offsets, and the equally nettlesome issue of Medicare solvency will be left for the new Administration and the new Congress.

Federal Pension Legislation and Regulation

Senate goes home for election without acting on clarification of interest crediting rule for State and local DB plans

The Senate left town without completing action on a package of pension technical corrections passed earlier by the House that includes a provision to prevent State and local defined benefit plans from being swept up into rules aimed at curbing abuses in the context of cash balance conversions in the private sector. These rules aimed at private sector abuses would cap the permissible interest crediting rate used by a governmental defined benefit plan at the long-term bond rate. It is possible that the Senate would take up the pension technicals package during a brief “lame duck” session that is expected after the election.

Legislation to mandate more transparency of fees and investment options in section 403(b), 457, and 401(k) plans

Wide-ranging legislation to require greater transparency of section 401(k) investment and management fees and disclosure of potential conflicts of interest by plan consultants, promoted by House Education and Labor Committee Chairman George Miller (D-Martinez), has died in the House, amid continuing controversy and opposition in the investment advisor/asset manager community and a lack of interest in legislative action on the Senate side. With a stronger Democratic majority expected in the House in the new Congress, Chairman Miller is likely to make a renewed effort to enact this legislation.

Initiatives of Interest to CalSTRS as Investor

Sovereign wealth funds agree to voluntary code of conduct

The multilateral effort to “regulate” sovereign wealth funds led by the International Monetary Fund (IMF) has succeeded in its effort to reach agreement with sovereign wealth funds on a set of voluntary best practices. The two dozen principles, known as the “Santiago Principles” after the meeting place they were hashed out, were officially announced by the IMF on October 11. In brief, this voluntary code of conduct would require the sovereign wealth fund to have in place a transparent and sound governance structure that provides for adequate operational controls, risk management, and accountability. In addition, the sovereign wealth fund would commit to compliance with the governing regulatory and disclosure requirements in the countries in which they invest. Further, the principles seek to ensure that the sovereign wealth funds invest on the basis of financial risk and return related considerations, rather than political considerations. Finally, the principles recognize the positive contribution of sovereign wealth funds to maintaining a stable global financial system and free flow of capital and investment. (We have the lengthy IMF paper on the Santiago Principles, if anyone wishes the further detail.)

The OECD continues its parallel effort to develop a code of conduct for countries that are the recipients of sovereign wealth fund investments, but progress appears slower, likely because the industrialized countries have shifted their focus to saving their financial markets in the first instance.

Iran divestment legislation dies in the Senate

Legislation to facilitate divestment of holdings in businesses dealing with Iran’s energy industry died on the Senate Floor as Congress adjourned, a victim of Bush Administration objections that the legislation intruded on Executive Branch prerogatives over foreign affairs. However, such legislation could well serve as a template for a renewed Iran sanctions effort under a new Administration.

The key Senate measure was the “Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2008” (S. 3445), that had been adopted by the Senate Banking, Housing and Urban Affairs Committee on a broad bipartisan vote. The legislation would have required for the first time, preparation of a Federal list of U.S. and foreign persons investing in the Iranian energy sector. The President would have been required to report to Congress every six months on every U.S. or foreign person who has invested at least \$20 million in Iran’s petroleum sector, accompanied by a determination as to whether such investment violates the sanctions.

The legislation would have “authorized” divestment of investments in businesses investing in Iran’s petroleum sector as follows:

- ***Divestment for reasons of reputational or financial risk:*** Expresses the sense of Congress that the U.S. government should support efforts by State and local governments to divest from, or prohibit investment of the assets of state or local governments in, a person that the government determines poses a financial or reputational risk.

- ***Authorization of divestment:*** Gives “authority” to State and local governments to divest from any company that invests \$20 million or more in the energy sector in Iran, or extends \$20 million or more in credit to be used for investment in the energy sector in Iran. While not mandating divestment, this authorization is to recognize that investors may have moral, prudential or reputational reasons to divest from companies that accept the substantial business risk of operating in countries subject to international economic sanctions.
- ***Standards for divestment:*** Requires advance written notice to persons to which the measure is to be applied; offers an opportunity for comment by the person to which the measure would be applied (including an opportunity to demonstrate that the person does not engage in the prohibited investment activities related to Iran’s energy sector); urges care by State or local governments related to erroneous targeting of divestment; and requires written notice to the Department of Justice within 30 days of enactment of divestment legislation or adoption of other similar divestment measures.
- ***Safe harbor for asset managers:*** Prohibit legal action against asset managers who, based on credible information available to the public, choose to divest assets from, or avoid investing in, persons investing \$20 million or more in Iran’s energy sector, or extending credit for such investments in Iran’s energy sector.
- ***SEC divestment regulations:*** Requires the Securities and Exchange Commission to revise current regulations as necessary to require disclosure of Iran divestment actions.
- ***Divestment permissible exercise of fiduciary duty for private pension plans:*** Expresses the sense of Congress that managers of private sector pension plans may divest plan assets from, or avoid investing in, persons investing directly or indirectly in Iran’s energy sector, without breaching their fiduciary obligations under ERISA -- if their decision is made based on credible publicly available information, and is conducted consistent with current Department of Labor regulations related to economically targeted investments.

As noted above, while this Iran sanctions legislation may have become bogged down this year amidst GOP objections at the behest of the Bush Administration, such sanctions legislation is likely to be given renewed attention in the new Congress, particularly if Iran continues down its current path of controversy. In addition, the legislation outlined above is emerging as a template for future divestment legislation for other countries and other causes in the Congress.

***Climate change legislation likely to return in new Congress;
emerging practice of greater corporate disclosure***

On the legislative side, this was supposed to be the year in which Congress kicked off serious debate on bipartisan legislation to control carbon dioxide emissions. While no one expected final enactment of such legislation this year, the Congressional debate was seen as setting the stage and framing the issues for serious consideration next year.

Legislation promoted by the Chairmen of the relevant Senate and House Committees – the Senate Environment and Public Works Committee and the House Commerce Committee – would have imposed a so-called “cap and trade” system under which overall emissions would be limited, and emissions allowances would be traded under a market-type arrangement. The Senate measure also included a provision directing the Securities and Exchange Commission to require securities issuers to inform investors of material risks related to climate change.

However, this climate change legislation fell prey to partisan bickering. The legislation is expected to receive renewed serious attention in the new Congress.

In the meantime, as public concern over climate change continues to grow, an increasing number of publicly-traded companies are addressing the business risks arising out of climate change in the disclosure documents the company files with the Securities and Exchange Commission. Much of the impetus for this enhanced disclosure of the effect of climate change risk upon the company’s business and financial results has come from a combination of regulatory, investor, and legislative pressures.

New York State Attorney General Andrew Cuomo issued subpoenas under New York’s securities laws to five of the nation’s largest energy companies (AES Corporation, Dominion Resources, Dynegy, Peabody Energy, and Xcel Energy) requesting information regarding the disclosure of climate change risk in the companies’ public filings. On August 27, 2008, Mr. Cuomo announced an agreement ending the investigation into Xcel contingent upon Xcel’s disclosure of certain climate change risks in its annual report on Form 10-K. Mr. Cuomo accompanied this announcement with a statement that the agreement “sets a new industry-wide precedent that will force companies to disclose the true financial risks that climate change poses to their investors.” Under this agreement, Xcel must provide the following disclosures in its SEC filings:

- Analysis of material financial risks from present and probable future regulation with respect to climate change, including
 - Identification of current regulation and discussion of expected trends in future regulation in jurisdictions in which Xcel operates;
 - Analysis of material financial effects, including discussion of factors that may affect the company’s business;
- Analysis of material financial risks from physical impacts of climate change, including sea level, weather conditions and extreme weather, changes in precipitation, and changes in temperature;
- Analysis of material financial effects of climate change-related litigation to which Xcel is a party and any climate change-related decisions, judgments, or orders in jurisdictions in which the company operates that may have a material financial effect;
- Strategic analysis of climate change risk and emissions management;
 - The company’s “current position on climate change”;
 - The company’s estimated greenhouse gas (GHG) emissions;
 - The company’s expected increase in GHG emissions from new coal-fired generation;

- The company’s strategies to reduce climate change risk, including actions to limit GHG emissions;
- The results of strategies undertaken to date; and
- The expected effect of strategies on future GHG emissions and GHG emission reduction goals the company seeks to achieve.¹

The current SEC rules do not identify climate change or climate change regulation as line-item disclosures or as phenomena that companies must consider in disclosing risk. Nevertheless, the following emerging trends reflect increasing public concern about climate change that may influence regulatory actions and affect the nature of risk assessment and disclosure by public companies;

- An increase in the number of shareholder proposals that seek to require public companies to disclose certain information or undertake certain actions related to climate change risk.
- A sharp rise in voluntary disclosures of climate change risk information by public companies, with many companies publishing sustainability reports or participating in such initiatives as the Carbon Disclosure Project. (The Carbon Disclosure Project indicates that over 75% of Fortune 500 companies responded to its 2007 survey, although the nature and completeness of the responses vary widely.)
- An apparently heightened consideration by companies in Europe and the United States of voluntary disclosure of climate change risks in the course of satisfying other general disclosure and reporting requirements. Many European companies also publish sustainability reports that go beyond the disclosures required by the mandatory reporting process.

¹ The legal bases for requiring such disclosure include the following provisions of the SEC’s Regulation S-K:

- Item 101, which requires a narrative description of the company’s business, including disclosure of the material effects that compliance with federal, state, and local laws regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have on the company’s capital expenditures, earnings, and competitive position;
- Item 103, which requires disclosure of material pending legal proceedings to which the company is a party or to which its properties are subject, including proceedings in which the company is not directly a party but which may have a material impact on the company’s business or financial condition;
- Item 303, which requires disclosure of known trends or uncertainties reasonably likely to have a material impact on the company’s liquidity, capital resources, and results of operations; and
- Item 503, relating to risk factor disclosure, which requires a discussion of the most significant factors that make an investment in the company’s securities speculative or risky.

- A petition submitted to the SEC in September 2007 (and renewed in June 2008) by a large group of environmental organizations and institutional investors, led by the Environment Defense Fund and CERES, urging the SEC to issue a statement that companies should consider climate risk in their review of information that may be material and subject to disclosure.
- A request submitted to the SEC in December 2007 by the chairs of the Senate Committee on Banking, Housing and Urban Affairs and the Senate Subcommittee on Securities, Insurance and Investment requesting the SEC to issue an interpretive release ensuring greater completeness and consistency in disclosure of information related to climate change.
- The passage by the California Senate in August 2008 of Senate Bill 1550, which would require the Secretary of State to establish standards for climate change disclosure for public companies doing business in California.

To see how the disclosure practice of one sector of SEC-reporting companies has been affected by these and similar trends, Hogan & Hartson reviewed the climate change-related disclosures provided by several dozen major public utilities in their 2008 annual reports on Form 10-K. The following summary reveals the extent to which public utilities are disclosing climate change risk:

- 85% of the companies reviewed discuss current and possible future systems of climate change regulation, of which 60% discuss material effects of climate change regulation on their businesses and financial results and 40% acknowledge that climate change regulation could have a material effect;
- 30% of the companies reviewed discuss their strategies to address climate change and the results of those strategies, while an additional 10% simply identify a company strategy addressing climate change;
- 25% of the companies reviewed disclose actual GHG emissions, while an additional 30% disclose the level of GHG emissions relative to their industry;
- 20% of the companies reviewed discuss climate change litigation to which they were not parties that could have a material effect on their businesses and financial results; and
- 15% of the companies reviewed disclose financial risks from physical impacts of climate change.

***Shareholder “say on executive pay” concept
briefly resurfaces in financial bail-out legislation***

Though the bipartisan, House-passed legislation (H.R. 1257), spearheaded by House Financial Services Committee Chairman Barney Frank (D-Mass.), to provide shareholders of publicly-traded companies with an advisory vote on executive compensation died a quiet death in the Senate amid GOP objections, the “say on pay” concept enjoyed a brief resurgence in the context of the financial bail-out legislation. Early House versions of the bailout legislation drafted by Chairman Frank would have included a shareholder advisory vote on executive compensation for companies that chose to participate in Treasury’s troubled asset program.

However, the “say on pay” provision ultimately was dropped from the final version of the bailout legislation at the behest of Treasury Secretary Henry Paulson, who opposed the inclusion of any provision that could discourage troubled financial institutions from participating in the troubled asset purchase program. In place of the “say on pay” provision is a general precatory instruction by Congress that Treasury require that financial institutions participating in the Treasury program “meet appropriate standards for executive compensation and corporate governance”, along with a prohibition on executive compensation arrangements that encourage “unnecessary and excessive risks”, a prohibition on golden parachutes, and a so-called “claw-back” provision under which the financial institution can recover any incentive compensation for an executive that is later found to be “based on statements of earnings, gains, or criteria that are later proven to be materially inaccurate.”

To Chairman Frank’s credit, he has now gained legislative adoption of some of the key concepts in his original executive compensation legislation, and he is likely to be looking for new opportunities in the next Congress to enact these concepts more broadly amidst public ire over executive compensation practices at the major financial institutions that have lately been falling into the taxpayer’s arms.

Pension funds as commodities speculators – well never mind

With the drop in oil prices in half, the effort to blame institutional investors in general, and public plans in particular, for supposedly barreling into investments in commodities and commodities-based indices and derivatives, sending prices soaring, is fast fading into the background.

As you recall, key Members of Congress had promoted legislation barring pension funds from investing in petroleum and agricultural commodities. In addition, Sen. Charles Grassley (R-Iowa), the ranking Republican on the tax-writing Senate Finance Committee, sought to tax institutional investor trading in oil and gas commodities. The drop in commodity prices and the financial market crisis ultimately sapped the momentum from this legislation. However, the memory lingers on as a cautionary tale of the ready willingness of otherwise clear-eyed Members of Congress to pursue legislation that would have the effect of barring a particular set of legal investments to pension funds simply because they are pension funds.

Congressional tax-writing committee leaders call for greater regulatory guidance and oversight on private pension plan investments in hedge funds and private equity

A U.S. General Accountability Office (GAO) study completed in late August found increasing levels of investments by private pension plans in hedge funds and private equity funds. The study is entitled, “Defined Benefit Pension Plans – Guidance Needed to Better Inform Plans of the Challenges and Risk of Investing in Hedge Funds and Private Equity”. Arguing that these types of investment vehicles typically have lower levels of liquidity, less transparency, and greater levels of risk than many traditional investments, Senate Finance Chairman Max Baucus (D-Mont.) and House Ways and Means Chairman Charles Rangel (D-N.Y.) called for the U.S. Department of Labor to issue regulatory guidance under ERISA to

assist private plan fiduciaries, particularly small plans, in assessing and performing due diligence on hedge fund and private equity investments. Public plans are exempt from ERISA, and for once the GAO report does not sweep in State and local retirement plans as having a particular problem in this area.

Think Tank Study Calculates that DB Plans Provide Retirement Benefits at Half the Cost of DC Individual Account Plans

Defined benefit pension plans can deliver the same level of retirement benefit at a 46 percent lower cost than a defined contribution individual account plan, according to a recent study by the National Institute on Retirement Security. The study, released in August, is entitled “A Better Bang for the Buck: The Economic Efficiencies of Defined Benefit Pension Plans”.

The study cited three principal components of this cost savings of DB plan benefits relative to DC plans:

- Pooling of longevity risks of large numbers of participants, resulting in a 15 percent cost saving;
- Maintaining an optimally balanced investment portfolio that is “ageless”, as compared to the typical investment strategy of an individual investor of “down-shifting” over time to a lower risk/return asset allocation as retirement approaches, resulting in a 5 percent cost savings; and
- Achieving higher investment returns as compared to individual investors by reason of professional asset management, economies of scale, and lower fees, resulting in a 26 percent cost savings.

Elk Hills Compensation

Maybe the 10th year will be the charm.

The stream of Elk Hills compensation that thus far has produced a total of \$300 million in Elk Hills compensation began in FY 1999. As we move into the Federal appropriations process for FY 2009 and 2010, we remain hopeful that, with a new Administration, a resolution will emerge soon of the pending litigation between the Federal Government and Chevron over the Department of Energy’s alleged misconduct in the process used to determine the proper equity split of the proceeds from the Elk Hills sale. Since CalSTRS shares in the Federal Government’s piece of the sales proceeds, we are left to further await the resolution of this dispute in order to move forward on the last installment of Elk Hills compensation that could exceed \$20 million. This last installment would boost CalSTRS’s total Elk Hills compensation to more than \$325 million.

In the new Congress, we will continue to coordinate with our ever-patient Congressional champions – Reps. Adam Schiff (D-Pasadena) and Kevin McCarthy (R-Bakersfield) on the House side and Sen. Dianne Feinstein (D-Ca.) in the Senate – to maintain the visibility of the Elk Hills compensation claim and to continue the press for payment of the remaining piece of compensation.

One last historical postscript. It was then Chairman of the Senate Armed Services Committee John McCain (R-Ariz.) who, as a condition for his Committee's approval of the original Elk Hills sale legislation, forced the State to receive its compensation by way of seven separate annual trips through the expected futility of the Congressional appropriations process, rather than automatically paying the State as House leaders had wanted. Food for thought as you pull the lever for the Administration that will control the last installment of Elk Hills compensation

John S. Stanton
Hogan & Hartson LLP

Washington, DC
October 14, 2008

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September 11, 2008

Exhibit A (Attachment 1)

Regular Meeting - Item 5

November 6, 2008

Mr. Steven Lehmann
Chairman
Public Interest Committee
American Academy of Actuaries
1100 Seventeenth Street NW, Seventh Floor,
Washington, DC 20036

RE: Disclosure of Market Valuation of Assets and Liabilities for Public Pensions

Dear Mr. Lehmann,

The public retirement systems that cover State and Local Government employees across our nation stand out against the backdrop of growing retirement insecurity. Public pensions have not missed paying a monthly retirement income check to retirees. That is why I am especially concerned about proposals to adopt a liquidation value model for valuating public pensions using a snapshot approach to value liabilities that can only be paid over decades.

As I indicated earlier, one area where workers and retirees have good news is public pensions. I believe that public pensions get retirement security right. As a group, these systems are well funded and they have paid billions of dollars of secure retirement benefits for millions of retired public servants for many decades. They represent a cost-effective, efficient use of taxpayer funds. The public interest is being well served by these pensions. The record of the Joint Economic Committee at hearing in July 2008 clearly substantiates this fact.

As the American Academy of Actuaries continues its public discussions relating to the disclosure of public pension system liabilities, I urge the Academy to consider carefully, and guard against the risks of adverse consequences from its deliberations. Specifically, there are serious risks with respect to so-called "market value of liability" measurements. Unlike private sector pension plans, there is no liquidation risk for public pensions since state laws and constitutions protect pension benefits from being frozen or terminated on a given day. Artificially measuring the plan assets and liabilities at market value, is akin to "liquidation reserving". There is clearly no need for this misleading disclosure for public pensions called for by advocates of financial economics. Governments do not routinely disclose any type of liquidation measures and they should

not need to do so for their pension promises. The flaws in this measure are numerous, the potential negative consequences are enormous, and the potential benefits are dubious. In times of economic contractions, pension contribution requirements would increase to the higher levels; while in more prosperous times annual contributions would trend lower. Virtually all experts on public pensions feel the calculation is unnecessary and fraught with risks and would not result in better funding of pension liabilities.

I am very concerned that the reporting of flawed measurement of a pension system's funded status will have negative consequences for public plans. Such an outcome would have adverse effects on employees' retirement security and would undermine the goal of fiscal responsibility to taxpayers. Simply put, such an outcome would run counter to the public interest.

Thus, I urge the Academy to exercise caution in its deliberations, and to permit broad consideration of all policy alternatives that may enhance the twin objectives of strengthening retirement security and responsible use of taxpayer funds.

Thank you for your kind consideration of my views on this subject and for your work on this important issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Earl Pomeroy", with a large, sweeping flourish at the end.

EARL POMEROY
Member of Congress

EP:do

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Congress of the United States

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BRETT LOPER,
MINORITY STAFF DIRECTOR

September 29, 2008

Exhibit B (Attachment 1)

Regular Meeting - Item 5

November 6, 2008

Mr. John S. Stanton
Outside Counsel to CalSTRS
Hogan & Hartson
555 - 13th Street, NW
Washington, DC 20004-1109


Dear Mr. Stanton:

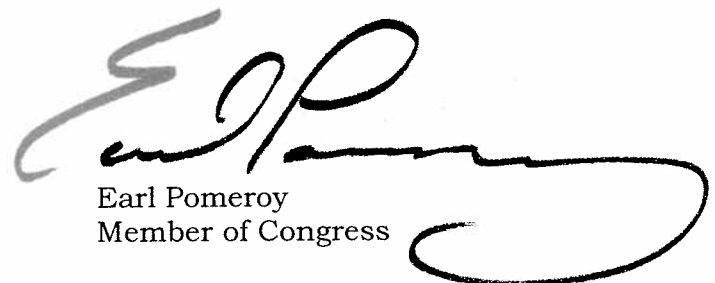
Thank you for taking time from your busy schedule to participate in the Internal Revenue Service (IRS) Roundtable on the development of a tax compliance structure for governmental pension plans that was held on Friday, September 19, 2008. As you know, our goal was to enable all interested parties to begin a discussion addressing the issues involved, and to build a foundation of trust as we move forward in this effort.

Your participation in this process is vital to the successful completion of the project that has been undertaken by the IRS. Your knowledge in this area will assist us in reaching our desired goal. Based on the feedback we have received on the roundtable, we think we are off to a good start. We look forward to your continued contributions to this process.

Again thank you for your participation. Should you have any questions, please feel free to contact Mildeen Worrell 202-225-5522 or Diane Oakley at (202) 225-2611.

Sincerely,


Charles B. Rangel
Chairman


Earl Pomeroy
Member of Congress

