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Mill Valley’s School District has placed Measure E on November’s ballot. It’s a parcel tax continuing the district’s existing tax to maintain Mill Valley’s universally acknowledged excellent public schools.

Two-thirds voter approval is required for passage.

The most controversial aspect of Measure E is a 5 percent annually compounded increase in the tax.

This isn’t peanuts.

The tax will rise from $980 per parcel of residential or commercial real estate in 2018, when the “renewed” tax goes into effect, to top out at $1,674 in the 2028-29 fiscal year, when the levy sunsets.

Given America’s present low 1.2 percent inflation rate, this kicker far exceeds any cost-of-living adjustment.

To learn the logic behind such a substantial annual increase I met with Emily Uhlhorn, chairwoman of Renew for Mill Valley Schools. What she told me has implications for every Marin school district.

Much of the funds generated by the 5 percent annual increase are needed to satisfy requirements of Assembly Bill 1469, now-adopted state legislation designed to close the gigantic $79.7 billion funding gap facing the California State Teachers Retirement System — or CalSTRS.

 Unsustainable promises negotiated all over California by aggressive public employee unions and compliant elected officials put taxpayers and school trustees behind the eight-ball.

It’s hard to criticize the intent behind AB 1469. The idea is that 30 years from now in 2046, CalSTRS’ unfunded liability will finally be satisfied.

Under this law, pension contributions deducted from classroom teachers and front-office educators will slightly increase from 8 percent of salary before the law was enacted to 10.25 percent in 2020.

Simultaneously, every school district in the state is required to more than double their payments to the teachers’ pension fund.

Mill Valley is typical. At present the district contributes 8.25 percent of each of its employee’s salaries to CalSTRS. That will zoom to 19.1 percent in 2020. On top of this pension payment escalator, school districts — like all Americans — face employee and retiree health care costs
rising 6.5 percent a year. Compare that to America’s current 1.1 percent inflation rate and it’s clear where much of the 5 percent inflator’s proceeds are going.

At least Mill Valley’s schools are ahead of the game. Its current parcel tax doesn’t expire until 2018.

The district has already established a trust fund to assist in paying down its pension deficit, squirreled away prudent reserves and devotes only a relatively modest 7.96 percent of its total budget to front office management.

Woe be it to other school districts that have put off reckoning with AB 1469’s implications and have not saved for the fast-approaching rainy day.

Without AB 1469, CalSTRS would be insolvent well before 2046. Even the pension plan’s bankruptcy wouldn’t take average Californians off the hook.

CalSTRS contends it only manages assets; it’s the districts that have the liability.” Taxpayers ultimately will pay the piper.

In a nutshell, that’s why Mill Valley voters face a ballot measure with a 5 percent compounded annual increase.

Of course, voters could simply reject Measure E and similar measures that will soon be popping up all over Marin.

That doesn’t mean that contractually obligated pension payments won’t be made.

In that event of a “no” vote, school trustees from around the Golden State will have little choice but to cut back across the board — including in the classrooms — to come up with the billions needed to pay off unrealistic pension promises made to educators.

Just as pension reformers have long warned, the day of reckoning is finally upon us.
DEBUNKING THE MYTH OF THE “TEACHER PAY GAP,” AGAIN (EducationNext, Commentary) 10-05-16

After adjusting for pensions and other benefits, teacher compensation is neither low nor falling

BY: Andrew G. Biggs and Jason Richwine

http://educationnext.org/debunking-myth-of-the-teacher-pay-gap-again/

Just in time for the start of the school year, the Economic Policy Institute (EPI) has returned to an old and familiar claim: Public school teachers are underpaid, and the pay gap is widening. The claim is perhaps too old and too familiar. EPI’s new report, authored by Sylvia Allegretto and Lawrence Mishel, is a repeat of its 2008 report, and as such, it ignores the important work on teacher compensation that has been done since. Allegretto and Mishel fail to address or even acknowledge major methodological advances in the literature in recent years that cast serious doubt on their conclusions.

Pensions

We start with pensions because they matter more than any other issue. The difference between the EPI authors’ pension valuation and the correct valuation is huge.

Allegretto and Mishel calculate the value of the pension benefits that teachers earn in a given year based on how much their employers contributed to their retirement plans in that year, using data from the Bureau of Labor Statistics’ Employer Costs for Employee Compensation (ECEC) survey. This was the same method the authors used in 2008. For a 401(k)-type plan, that approach works fine: the employer’s cost is nothing more than the amount contributed to workers’ accounts.

Most teachers, however, receive traditional defined benefit (DB) pensions, in which the employer promises not a contribution today but a fixed, guaranteed benefit in retirement. For such pensions, the conflation of contributions with benefits doesn’t work. In fact, the employer’s pension contribution in a given year bears no legal or mathematical relation to the pension benefits that teachers accrue in that year. Sometimes, governments facing unfunded liabilities will contribute more than is needed to cover accruing benefits. Other times, governments will shortchange the plan or even skip a contribution entirely. Nevertheless, teachers earn the same pension benefits in all of those years based on a formula written into law, and governments are legally obligated to pay when the bill comes due. Whether a government contributes nothing or an infinite amount, the benefits accruing to employees do not change.

Moreover, the way that state and local governments calculate their pension contributions means that two employees receiving exactly the same benefits could be assigned very different pension compensations under Allegretto and Mishel’s methodology. The DB plans funded by state and local governments, unlike private sector DB plans or DB plans for public employees in other countries, base employer contributions on how much a government assumes its plan’s investments will earn over time. For instance, the Connecticut teachers’ retirement plan assumes an 8 percent annual return, while the Indiana teachers’ plan assumes a much lower
6.75 percent return. Even if these two plans promise exactly the same benefits, Connecticut would contribute about one-third less toward its teacher pensions than Indiana would. Allegretto and Mishel’s ECEC data would then classify Connecticut teachers as receiving lower pension benefits, even though this difference is entirely due to how the two states chose to finance the same benefits over time. Connecticut makes lower contributions but takes more investment risk; Indiana does the opposite. But neither investment strategy tells us the benefits earned by teachers in those states.

This problem has a small effect when comparing teachers in one state to teachers in another. It has a massive effect when comparing teachers’ pensions to those of private-sector employees. While state and local governments may base their contributions on the assumption of roughly 8 percent investment returns, private-sector pensions, as well as most public pensions in other countries, are required to value their liabilities using a much lower bond yield to capture the fact that pension benefits are guaranteed against market or default risk. The sponsors of private plans must therefore contribute much more for every dollar of promised benefits than governments contribute to teacher pension plans that value liabilities using an 8 percent assumed return on portfolios heavily weighted with stocks, hedge funds, or private equity.

Virtually all professional economists agree that calculating the value of guaranteed pension benefits using the assumed return on a portfolio of risky assets “understate[s] their pension liabilities and the costs of providing pensions to public-sector workers.” We addressed this problem by adjusting the actuarial costs to a common discount rate that accurately reflects the low-risk nature of public pension benefits. When we did that in our 2011 analysis, we found that pension costs for teachers were worth not the 11 percent of wages reported by the ECEC but a remarkable 32 percent of wages. That figure reflects how much a worker with a 401(k) would need to save to receive the same retirement benefits with the same level of risk as those paid to the average public school teacher.

After we pointed out that ECEC-style data on annual contributions to public pension plans are a dramatic underestimate of pension costs, most of the pay comparison literature followed our lead in applying some kind of correction. Only one non-EPI study we know of continued to use the unadjusted ECEC, but that study’s authors explicitly noted the limitation.

The new EPI study on teachers never acknowledges the ECEC’s undervaluation of pension benefits and does not cite any of the above papers. Its readers would never know that a controversy over pension valuation even exists.

Retiree Health Benefits

While pensions are undervalued in the EPI report, the retiree health coverage provided to most teachers is ignored entirely. Most teachers earn the right to health benefits in retirement, which can provide full coverage from retirement through Medicare at age 65; they often receive supplementary benefits thereafter. Actuarial valuations show that in 2015, Texas teachers accrued future retiree health benefits equal to an additional 5.9 percent of their wages. For Illinois teachers, it was about 7.9 percent of wages. In New York City, it was 15.7 percent. In the
private sector, by contrast, retiree health coverage is much less generous—and rapidly disappearing altogether.

Because governments finance retiree health benefits on a “pay-as-you-go” basis—meaning that benefits are paid to retirees as they come due—the ECEC does not include any employer contributions for retiree health costs. Nevertheless, the benefits are real.

We pointed out this shortcoming of the ECEC in 2011, noting that “BLS data do not report on retiree health coverage for private sector or state and local government employees as these plans are generally unfunded, meaning there are no current employer contributions to measure.” Later in 2011, the Center for State and Local Government Excellence study cited above made the same point: “Clearly,” it said, “retiree health should be added” to benefits calculated from the ECEC data. The lack of retiree health benefits in the ECEC data has been known for years and has been corrected for in most of the recent literature. But, as with pension valuation, Allegreto and Mishel fail to mention the issue.

**Wages**

Allegreto and Mishel contend that teachers receive wages that are 17 percent lower than “comparable” workers. However, the basic controls they use, such as age and education, do not make worker skills comparable across occupations. Had Allegretto and Mishel included more occupational variables in their regression, readers would have discovered that virtually every occupation is either “underpaid” or “overpaid” by their reasoning. In fact, by simply replacing teachers with a different occupation, EPI could publish additional reports with titles like “The Food Service Pay Penalty” and “The Architect Pay Premium.”

Which is more likely: that the labor market has failed to provide the right level of average compensation to almost every occupation, or that workers simply differ in important ways beyond their age and the number of years they spent in school? Roughly half of public school teachers have education degrees, for example. Should an education degree be worth as much in the marketplace as an engineering degree? That is Allegretto and Mishel’s logic, despite strong evidence that education majors lag behind other college graduates in terms of marketable skills. None of this evidence is mentioned in their report.

A better test of whether current teachers are underpaid would be evidence that many have left the profession for better-paying jobs elsewhere. But despite all the anecdotes about teachers being lured away from public schools to lucrative private-sector work, the available evidence shows that, if anything, teachers earn less when they leave teaching for another job. Allegretto and Mishel do not address this evidence despite asserting that wage increases are crucial for retaining teachers.

**Work Time**

As they did in the 2008 report, Allegreto and Mishel rely on the weekly wages reported by public school teachers in the Current Population Survey, leading to confusion about whether the wage data refer to annual salary divided by 52 weeks or by some smaller number of weeks that reflects teachers’ shorter work year. Their new report rehashes a decade-old debate over that
technical issue, which is related to their 2008 claim that “all of the data available show that teachers work at least as many hours each work week as comparable college graduates.” That statement is no longer true, thanks to recent analyses of time-use data that Allegreto and Mishel fail to cite.

The American Time Use Survey (ATUS) captures work time throughout the year, as reported by employees themselves whenever and wherever work may occur. Multiple studies have used the ATUS to generate more accurate measures of how much time teachers spend working. In our own study, we found that teachers report working approximately two hours fewer than other professionals worked during a typical work week and about 83 percent as many hours over the full calendar year. Those reported hours included time teachers spent working at night or on weekends.

It is impossible to know whether Allegreto and Mishel’s weekly wage method implicitly captures a similar work year, and there is no reason to continue arguing about it. Using the recent ATUS results, researchers can adjust annual teacher salaries for their shorter work year simply by dividing by 0.83 (or a similar ratio if another specification is preferred). Why not take advantage of these new findings instead of persisting with an out-of-date methodology?

“Wider Than Ever”?

Even if Allegreto and Mishel undervalue teacher compensation each year, can we still conclude that teacher compensation has been falling relative to alternative jobs? Not necessarily, for two reasons. First, teachers’ unobserved skills may have fallen farther behind the skills of allegedly “comparable” workers during the same time period. This could happen for any number of reasons, but one of the most obvious is teachers’ tendency to increase their formal educational credentials without necessarily increasing their teaching skills. Between 1992 and 2014, the percentage of teachers with more than a bachelor’s degree increased from 46 percent to 56 percent, based on data from the Current Population Survey. In terms of formal educational credentials, teachers are one of the most highly educated occupations in the United States. At the same time, however, the average SAT scores for prospective teachers as reported by the College Board are middling and have risen only slightly since the 1980s.

Moreover, there is little evidence that postgraduate degrees for teachers either instill additional teaching skills or allow schools to identify individuals who are better teachers. According to the Urban Institute’s Matthew Chingos, “the fact that teachers with master’s degrees are no more effective in the classroom, on average, than their colleagues without advanced degrees is one of the most consistent findings in education research.”

This again highlights the problem with Allegreto and Mishel’s wage analysis. They state that “the small fraction of the most cognitively skilled college students who elect to become teachers has declined for decades.” In other words, teacher skills are falling. Yet, in terms of formal educational credentials—the key variable that they use to benchmark teachers’ wages against “comparable” workers—teacher quality has never been higher! As teachers increase their educational credentials without necessarily increasing their skills, the Allegreto-Mishel model
will show declining relative pay even if teachers are keeping pace with workers whose skills are truly the same.

A second reason that the teacher pay gap may not be “wider than ever” is that pension benefits have been increasing in ways not fully captured by the EPI report’s faulty methodology. In a review of teacher pension benefits, Robert Clark and Lee Craig write, “The main story of the past quarter century has been the increased generosity of teacher retirement plans. Normal retirement ages have been reduced, generosity parameters increased, and the number of years in the salary averaging period have been reduced. As a result, replacement rates rose by 5 percentage points, or almost 10 percent, between 1982 and 2006.”

Compounding the rising generosity of pension benefit formulas is the decline of interest rates on low-risk investments, which raises the cost of providing teachers with a fixed, guaranteed pension benefit. If state and local pensions were paying mind to interest rates—as they should, and as corporate and overseas public employee plans are required to do—contributions would have risen significantly as the yield on 20-year U.S. Treasuries dropped 3.7 percentage points between 2000 and 2016.

Thus, Allegretto and Mishel have not simply neglected to establish that a teacher compensation penalty exists; they have not even established that teacher compensation is falling behind that of competitive occupations.

**The Real Policy Questions**

The compensation of the average public school teacher relative to alternate occupations is, in a sense, a secondary question. Three million Americans have willingly chosen to pursue teaching at the pay rates offered by school systems, indicating that the pay, benefits, work conditions, and job satisfaction offered in the teaching profession are at least as attractive as what these individuals might receive in other jobs.

The larger question is whether higher teacher pay and benefits would boost teacher quality and student outcomes sufficiently to justify the additional costs. As Raj Chetty and colleagues found, better teachers are associated with better outcomes for students. But in school systems where pay is almost wholly determined by educational credentials and job tenure, neither of which is strongly associated with performance, it is unclear how much raising average pay would boost teacher quality—or whether it would boost it at all.

For instance, even when schools are offered more attractive candidates with specialized majors in the quantitative fields or with higher GPAs from more competitive colleges, school administrators often opt for seemingly less-qualified applicants who took the traditional ed school route. Moreover, if higher salaries attracted larger numbers of less-qualified applicants, then even fewer good new teachers might end up in the classroom. Raising salaries for all teachers irrespective of performance or specialty is unlikely to be the most effective or cost-efficient way to boost teacher quality and student outcomes.

**Conclusion**
Even in 2008, many researchers doubted EPI’s claims that public school teachers were dramatically underpaid. Since that time, the reasons to doubt this conclusion have only multiplied. If Allegretto and Mishel had incorporated recent methodological advancements involving pensions, retiree health benefits, wages, and work time, then their report would have been a genuine contribution to the state of knowledge on teacher-pay trends. Unfortunately, their methodology remains stuck in 2008, and their readers remain in the dark about an issue that deserves careful treatment.
L.A. UNIFIED BACKS DOWN AND AGREES TO PROVIDE LIFETIME BENEFITS TO CHARTER SCHOOL TEACHERS (Los Angeles Times, Education) 10-10-16

BY: Howard Blume


The Los Angeles school district and a well-known charter school have quietly resolved a conflict in a way that will help a group of employees but deepen the district’s long-term budget deficit.

L.A. Unified has agreed to pay lifetime health benefits for 10 employees who worked at El Camino Real Charter High School through last year. The employees formerly had worked at L.A. Unified, but left the district when the Woodland Hills school became an independent charter.

The employees — including eight teachers — then returned to L.A. Unified just long enough to file for retirement and thus qualify for the district’s lifetime benefits.

El Camino Real Charter is in charge of its own funding and manages its own benefits under a board of directors.

Six months ago, when senior officials learned of the employees’ intentions, L.A. Unified refused to provide the benefits, which will cost the district and taxpayers $2.5 million to $3 million over the life of the retirees, according to actuarial estimates. Nearly 50 charter teachers had done the same in the past without opposition from L.A. Unified.

But this time, district officials came under scrutiny after The Times inquired about the practice. And they disliked that El Camino paid bonuses as high as $30,000 apiece if the employees took their retirement costs away from El Camino.

Last week, district officials reversed themselves.

“We are going to honor our commitments to provide lifetime benefits to their employees,” said L.A. Unified General Counsel David Holmquist.

The reversal ultimately was based on direction from the elected L.A. Board of Education, which met in closed session over the issue.

The board was not legally obligated to report any action that it took, Holmquist said, because the matter related to a formal and confidential employee grievance.

The seven-member board includes both charter-school proponents and union allies. Most charters are not unionized, and unions and charters are typically at odds. But El Camino is that rare union charter, and the union wanted to protect its members’ entitlements.

California has more than 1,000 school districts. L.A. Unified is among about 70 that provide some form of post-retirement health benefits, which can be earned through long service. L.A.
Unified’s package is among the most generous. It’s also far from fully funded, contributing to an estimated future debt of $13.6 billion.

The district’s own chief financial officer called that financial obligation “scary.” It is one key factor threatening the long-term solvency of the school system. And paying it down means less money left for classrooms and for the salaries of current workers.

But the district declined to stand its ground after United Teachers Los Angeles, which represents the El Camino teachers, filed a grievance. Although grievance proceedings are confidential, multiple sources confirmed that the union asserted the district’s contractual obligation.

According to that contract, El Camino teachers had up to five years to return to L.A. Unified after the school left district control in 2011 — and would retain their previous rights if they did. For some, the union asserted, these rights included lifetime benefits, even if they retired without working another day in the district.

“LAUSD was obligated to take this action because of the collective-bargaining agreement,” said union President Alex Caputo-Pearl. “We ensured that the agreement was enforced and our members’ rights were upheld.”

In a statement, El Camino said it was ”extremely pleased,” adding that the charter “has always supported the best interests of our teachers and staff because of their exemplary service.”

L.A. school board members on Friday did not respond to requests for comment.

Although board members have talked repeatedly about the district’s dire budget situation, they have been reluctant to tamper with benefits — and in some instances have expanded them. In late August, the board approved health benefits for 4,200 part-time workers who were not among the thousands of part-time workers already covered under L.A. Unified plans.

L.A. Unified still offers the potential of lifetime benefits for new employees, but it’s much harder to earn them. Most would need to work for L.A. Unified for 25 consecutive years before retirement. And their age and years of service would need to equal at least 85 when added together.

El Camino, one of L.A.’s largest public schools, remains on the hook for potential lifetime benefits for most of its employees, who have a labor contract similar to the district’s. And that is not even its most pressing challenge. The school announced this week that it is parting ways with chief business officer Marshall Mayotte and that executive director David Fehte would see an unspecified reduction in his reported base pay of $221,475.

The school is trying to stave off a takeover from L.A. Unified following allegations of poor financial management practices and misspending by Fehte.
At Climate Week New York we launched our fourth annual global carbon pricing report. Each year we ask major multinationals who disclose to their investors and business customers through CDP if they are applying an internal price on carbon, and how they are using this to better manage climate-related risk and reduce carbon emissions.

As our report this year highlights, investors are asking companies to disclose this information to help them ascertain risks in their portfolios: a company using an internal price on carbon provides investors with some comfort that they are prudently planning for a world of carbon regulations.

Our carbon pricing report found that more than 1,200 companies - 23% more than last year - are now using an internal carbon price or planning to adopt one.

The use of an internal carbon price by companies is a fairly new phenomenon. Four years ago just 35 companies disclosed they were using one, though it appears to be heading towards a new norm of behavior to manage risk in capital markets. Given this rapid adoption it is not surprising that companies are using this tool in a range of different ways: from testing business strategies against future scenarios, such as Shell; as a real investment hurdle like ENGIE; and even to drive investment towards climate-aligned corporate goals, be it an emissions reduction target, an energy related challenge, or the creation of a new low-carbon product line, like Microsoft.

Close to 150 companies are embedding a carbon price deep into their corporate strategy. These companies are using it to deliver on climate targets, whether it be an emissions or energy related target or to help foster a new line of low-carbon products and services. They report that it helps by providing an incentive to reallocate resources to emission reduction investments, can
be used for creating a business case for R&D investments and, by assigning a financial value to both emitted and avoided emissions, it helps reveal hidden risks and opportunities.

Over 40 major multi-national companies with a combined market cap of US$1.5 trillion have disclosed tangible business benefits to us - from shifting investments towards energy efficiency measures, low-carbon initiatives, energy purchases and the development of new low-carbon product offerings. A very positive sign given this tool is relatively nascent. Companies in the energy and utility sectors were most heavily represented in the results. Others include technology companies like Microsoft, or the Swiss Pharmaceutical Novartis and carmakers such as Nissan and General Motors.

The number of companies disclosing they are in the process of adopting an internal price is increasing. There has been a considerable jump especially in Mexico, Brazil, India and Japan, as well as in the US.

What is driving the race to price carbon?

There are a number of drivers, including the growing momentum post the adoption of the Paris Agreement - which we expect to accelerate with its forthcoming ratification - and China’s impending carbon market. Novartis disclosed it has adopted a US$100 a metric ton carbon price to help it identify projects that will most cost effectively reduce greenhouse gas emissions. Saint-Gobain, SUEZ and Anglo American all use an internal carbon price to stimulate R&D into low carbon technologies such as fuel cells and construction materials.

Some of the businesses we talk to set a carbon price to inform future investment decisions. The French utility Engie disclosed it had decided to abandon new coal projects in 2015 in a belief that a carbon price will steadily be established across the world, and that coal fired plants will be adversely affected in the future. Societe Generale has saved €13 million on overheads by pricing carbon over a three-year period. TD Bank and Royal DSM are now pricing internally to underscore strategic shifts towards low-carbon operations and products.
Investors are also driving the carbon pricing agenda. They want to understand the inherent risks they are running in their portfolios in light of the changing landscape and are keen to ensure businesses are responding to a low carbon future. Jack Ehnes, CEO at CalSTRS takes climate change very seriously and is using CDP data to hold companies accountable to disclosing and managing climate risk and demonstrating they are preparing for a low-carbon economy.

The Taskforce on Climate-related Financial Disclosures (TCFD), established by Mark Carney and chaired by Mike Bloomberg, is considering recommending companies disclose forward looking risk against scenarios. Doing so against future deemed carbon prices is clearly one such way investors can assess potential future exposure.

![Internal price on carbon](https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/001/1322/original/CDP_Carbon_Price_report_2016.pdf?1474899276)

However some 500 companies in high emitting sectors still do not have or are not considering a carbon price. We believe these companies are potentially at risk from having a too short business planning horizon given how fast climate change issues are moving.

Some multinationals are starting to lead the way, but this time next year we expect to see carbon pricing be the new normal across markets globally. After all, with China’s adoption of a nationwide carbon pricing scheme expected before the end of 2017, every major corporation and investor will have a carbon price somewhere in their supply chain or portfolio.

The question is whether they understand how they will be exposed to this and are they prepared?

Think Your Retirement Plan Is Bad? Talk to a Teacher (New York Times, Your Money) 10-21-16

Schoolteachers and others who pursue careers of service in exchange for modest paychecks get lightly regulated retirement plans that often charge excessive fees.

BY: Tara Siegel Bernard

Margaret Jusinski first got to know her investment broker through the breakfasts he provided when he visited her public school in the leafy suburbs of New Jersey, where she teaches middle-school children computer coding and how to build robots made of Legos.

After the bagels, muffins and coffee, the broker made his sales pitch — and Ms. Jusinski bought it. So did many of her colleagues.

The teachers only recently learned how much those meals actually cost them.

Had she been able to choose a simpler, less expensive plan instead of the broker's costly offering, Ms. Jusinski would have approximately 20 percent more in savings, according to an analysis performed for The New York Times. One colleague would have a balance 50 percent fatter. The list goes on.

“It is a heartbreaking situation for everyone,” said Ms. Jusinski, a mother of two girls who turns 50 on Sunday. “Especially for the staff members who were looking to retire within the next few years.”

Most Americans who save for retirement at work have 401(k) plans, which are generally offered by companies and must by law provide a mix of prudent investment options. But millions of Americans — public school teachers, clergy members, employees of religious institutions or nonprofits, and some charities — are not offered 401(k)’s. Instead they typically must rely on what are known as 403(b) plans, many of which are more lightly regulated.

As a result, the people who do the most good in the world, spending their careers helping others in exchange for modest paychecks, often get the worst retirement plans. In fact, millions of people who save in 403(b) plans may be losing nearly $10 billion each year in excessive investment fees, according to a recent analysis by Aon, a retirement consultant.

“It's a wealth transfer from those who don't know any better — Main Street — to those who do: Wall Street,” said Scott Dauenhauer, a financial planner who works with public schoolteachers.
and as a consultant to school plans. “What makes me the most angry is that public school employees are not protected the same as their private sector counterparts.”

Named for a section of the tax code, many 403(b) accounts are riddled with complicated, expensive investment products that can cost their owners tens of thousands of dollars, if not more, over their careers. The 403(b) accounts that many workers contribute to are not subject to the more stringent federal rules and consumer protections that apply to 401(k) plans. In fact, of the $879 billion in total 403(b) assets, more than half is not subject to federal retirement plan rules, according to Cerulli Associates, a research firm.

Those assets also escaped tighter protections issued in April by the Obama administration, which will require brokers to put the interests of their customers first when handling retirement dollars. “There is very little, if any, oversight, so you often end up with conflicted advice, high fees and low service,” said Marcia Wagner, an employee benefits lawyer who has been practicing for more than 30 years.

While some school districts and states have begun vetting plans for public school employees, most teachers must still sort through a bewildering list on their own. Instead of just one provider offering a selected range of low-cost mutual funds — which is typical in a 401(k) plan — teachers and other public school workers might see options from several large providers, each with a dizzying array of prospective investments. In some places, including California, Ohio, Texas and Washington, the lists may run much longer because of state laws that require it. Public school workers in California, for instance, have access to up to 59 providers and more than 220 investment products.
Often the providers are insurers like Valic, Voya, AXA and Lincoln Financial. And while a 401(k) plan might offer a small collection of plain-vanilla mutual funds that, say, track a major stock index or invest in bonds, the investments in many 403(b) plans are typically held inside annuities, which can be much more confusing.

For instance, many teachers are encouraged to invest in high-cost variable annuities, typically explained in thick instruction manuals filled with jargon. Buyers who later decide they want to move money into a lower-cost investment vehicle often learn their savings are being held hostage: Pay a surrender fee or the money must remain in the annuity.

Mark Eichenlaub, a seventh-grade language arts teacher who coaches cross-country track in Flossmoor, Ill., decided to pay the fee, about 5 percent of his balance, just so that he could extricate himself from a variable annuity sold by AXA, which subtracted more than 2.34 percent of his balance each year. In contrast, large 401(k) plans charge less than half a percent annually, according to BrightScope, a financial information company.

In a relatively short time, his costly switch “will pay for itself,” said Mr. Eichenlaub, who is 38. (After months of lobbying his district for a lower-cost option, he persuaded school authorities to add one to their lineup this year.)

Despite the high cost of many 403(b) accounts, they are likely to play an increasingly important role paying for educators’ retirement. For one thing, teachers in about a dozen states may not qualify for Social Security. And while public schoolteachers often are offered decent pensions, many of them do not work for the decades required to qualify for a full payout. And pension formulas are becoming less generous for newer recruits.
The 64 million workers with 401(k) accounts are covered by the Employee Retirement Income Security Act of 1974, overseen by the Labor Department. The law outlines minimum guidelines and protections for workers and requires employers or plan overseers to act in the best interests of participants.

But most assets in 403(b) accounts are invested in the murkier side of the market, which is not covered by the federal law, known as Erisa. Many hospitals and private colleges tend to hew more closely to Erisa standards, but a series of recent lawsuits against prominent universities argue there is still room for improvement.

New regulations from the Internal Revenue Service in 2009 helped tidy up some 403(b) administrative details. For instance, employers offering 403(b) plans were required to create a document detailing how the plan would be governed. But larger problems remained.

In many cases, basic information about costs isn’t readily available online, only through an agent, which can have its own problems.

Tracee Huffman, a 26-year-old who teaches seventh and eighth graders in Norfolk, Va., became so fed up waiting for the representative to get back to her — it took more than six months — that she educated herself about costs and decided her personal individual retirement account was a better deal. “I have emailed the other vendors, but they always refused to respond to my questions via email,” Ms. Huffman said. “They would prefer I drive to meet with them when my question is simple: ’Do you have a 403(b) that has an expense ratio under 1.5 percent? If so, I’m yours.’”

The teachers at Ms. Jusinski’s school in New Jersey, which is in the affluent Bergen County town of Ho-Ho-Kus, recently learned they were paying more than that — sometimes much more.

Outside their school on a sunny afternoon in early June, parents picked up their children beneath a canopy of tall oak trees. And inside the school, half a dozen teachers gathered in a former kindergarten classroom that had a fireplace and bookcases with doors made of leaded glass. Together, they assessed the collective damage to their 403(b) plans.

One of Ms. Jusinski’s colleagues, Karen S., is a 62-year-old widow nearing retirement who agreed to discuss her situation if her last name was not used to protect her family’s privacy. At the end of 2015 she would have had an additional $113,000 in savings — or nearly 50 percent more — had she not paid approximately $37,500 in commissions and various fees over the previous eight years and had instead invested in a simpler mix of low-cost stock and bond funds, according to an analysis performed by Mr. Dauenhauer, the 403(b) consultant.

“I am running around in my little Honda because someday I need to retire and there is no Plan B,” she said.
Her husband died of brain cancer when their three boys were 3, 5 and 7, leaving her to raise the children on her own.

(Mr. Dauenhauer, who reviewed both her account and Ms. Jusinski’s, had no business relationship with the plans the teachers choose from.)

Ms. Jusinski paid more than $15,000 in fees and commissions over the previous eight years on an $87,000 account. She would have had almost $105,000 at the end of 2015 if she had been invested in a standard mix of low-cost stock and bond funds, according to Mr. Dauenhauer’s analysis.

The teachers were each charged a fee of at least 2 percent of their savings to manage the money, in addition to sales charges of up to 6 percent each time they made a deposit, the analysis found. Moreover, the calculations didn’t include the expenses of the dozens of mutual funds they were invested in, some of which exceeded 1 percent.

The Legend Group, the provider of the investments all these teachers hold, last year fired Walter Marino, their broker, according to a spokesman for the firm, who said his departure was unrelated to the investment fees. Mr. Marino didn’t return calls seeking comment on his departure from Legend.

In August, after the teachers complained about their investments, Legend sent them letters stating that the charges “were consistent with the firm’s policies.” More recently, though, Legend met with them to seek more information about how much money they thought they lost.

Diane Mardy, the Ho-Ho-Kus superintendent of schools, said she hoped “that a spotlight is put upon this issue so that more safeguards are put in place for us all.”

The same broker, Mr. Marino, is involved in a similar dispute about a 90-minute drive east, in Copiague, N.Y.

At the local high school there, Valarie Williams, a 51-year-old speech pathologist, met with Mr. Marino after receiving a notice in her school mailbox saying that his firm, Legend, would visit to help teachers analyze whether their retirement portfolios were on track. “They brought snacks and all of that,” she recalled. In the end, Ms. Williams, who is divorced, said she transferred about $170,000 to Legend in the spring of 2014.
Mr. Marino helped her fill out the paperwork at her home, where she lives with two of her grown children, both disabled: a 27-year-old son with Down syndrome and a 25-year-old daughter, blind and severely disabled, whom she carries to her mother’s house next door most mornings before work.

But within months, she said, she felt something wasn’t right, nor could she make sense of her “convoluted” statements. She was still making contributions, but her balance was always less than her original investment. “The market wasn’t that bad,” Ms. Williams said. “I expected normal fluctuations.” The broker told her that her account was “highly managed” and that she had to be patient.

One day, when photocopying her Legend statements at school, another teacher noticed and remarked, “Oh, you’re with Legend, too?” That teacher had a similar experience — and word spread beyond the copy room.

“That teacher told another teacher, then all of a sudden people started reaching out to me,” Ms. Williams said.

Two years after transferring her money, she, along with some current and former colleagues, are working with a lawyer to explore their options on how to resolve their situation with the brokerage firm. Ms. Williams’s lawyers said the teachers were charged multiple types of fees on their accounts, similar to what the teachers in New Jersey experienced.

“In cases like that, I call it using somebody’s money as the firm’s proprietary account,” said Jenice Malecki, Ms. Williams’s securities lawyer, who is also representing other employees at her school. “The firm takes all the profit and the customer gets nothing.”

Joseph Kuo, the Legend Group spokesman, declined to comment on whether it thought the teachers were charged excessive fees.
Legend was on both schools’ list of 403(b) providers, providing teachers with a sense of security. “When you tell your employees this is an approved product, they automatically assume the district did some due diligence on it,” said Barbara Healy, a 403(b) consultant based in Scottsdale, Ariz. “And for the most part, the district does not pay any attention.”

Participants in retirement plans covered by Erisa, the federal law, generally have the right to sue the plan overseer for failing to act in an employee’s best interest. But many public school teachers can typically resolve grievances only through arbitration, since most investment providers mandate that disputes be settled that way.

The New Jersey teachers also turned to their local union for help, hoping they could find a better program to put their money in. The union representative recommended a sales agent affiliated with the retirement program run by the National Education Association, a union with three million members.

But the union’s products weren’t much different from what the teachers already had.

The N.E.A.’s Member Benefits group, a subsidiary, exclusively endorses a set of products from Security Benefit, a financial services company with nearly $32 billion in total assets that creates fixed and variable annuities and offers mutual funds. (The union’s program for teachers receives at least $2.7 million from Security Benefit each year, according to regulatory filings, which it said it paid to operate the program.)
The products include an array of mutual funds, various annuities — and one lower-cost option in which investors can choose inexpensive index funds without a broker’s assistance. But most new money from school employees is invested in the mutual funds sold by brokers, according to Gary Phoebus, chief executive of N.E.A. Member Benefits.

Fees in that program range from 0.35 to 1.25 percent. But that doesn’t include another layer of expenses for the underlying investments, which run from 0.59 to 2.11 percent, according to Security Benefit, and in some cases additional sales or surrender charges.

For comparison, total costs at a typical large 401(k) generally fall under 0.5 percent. Mr. Phoebus defended the program, saying it offered a wide variety of options “to meet the diverse needs and comfort levels of members.” The goal, he explained, was to balance fees while providing access to advice.

However, some employees of the union itself, as opposed to its subsidiary, do receive a better deal. Many are offered a 401(k) retirement plan managed by Vanguard, a mutual fund company known for its low costs.

As for Ms. Jusinski, the technology teacher in New Jersey, she has wrested back control of her retirement account, investing in the union’s do-it-yourself option. But she worries about her fellow teachers all over the nation, still stuck in costly 403(b) plans.

“So many are mismanaged, shady operations,” she said. “It’s a crime.”

—Susan Beachy contributed research.
A surprising reason dissident actuaries advocate using a much lower earnings forecast for public pension investment funds is “intergenerational equity,” ensuring that the pensions of government workers are paid by the generation that receives their services.

A recent paper by the dissidents does not mention the usual criticism that pension earnings forecasts are too optimistic, not likely to be achieved, and hide massive underfunding. When the earnings forecast is lowered, pension debt or the “unfunded liability” goes up.

For example, the “California Pension Tracker” website shows California public pensions in 2013 with a debt of $281.5 billion when a typical 7.5 percent earnings forecast is used. Drop the earnings forecast to 3.7 percent and the debt soars to $946.4 billion.

The paper’s authors are dissidents because they follow the principles of mainstream financial economics, not standard actuarial practice, when they advocate a risk-free earnings forecast to discount debt for guaranteed pensions, something like a U.S. Treasury bond.

“Our analysis seeks to maximize efficiency and preserve intergenerational equity,” said the paper issued by the dissidents last August. “We conclude that full funding based on default-free discount rates is efficient and fair across generations.”

With little or no risk of loss, investments with predictable yields could closely match the cost of pensions workers earn during a year, minimizing debt passed to future generations. But that would be costly. The yield on the 20-year Treasury bond last week was 2.2 percent.

The $300 billion diversified CalPERS investment portfolio, about half in stocks, is expected to earn an average of 7.5 percent. But after huge investment losses, CalPERS is 68 percent funded with a $139 billion unfunded liability being paid off over 20 to 30 years.

The dissidents contend that under the basic public finance principle of intergenerational equity, each generation should pay for the services it receives. So, for example, the cost of a police officer and a police station should be financed differently.

The total compensation of a police officer, pay and pension, should be paid for out of the current operating budget. But the cost of a newly built police station can be paid off over time because, unlike the officer, the station will serve current and future generations.

Intergenerational equity is not a new notion. When the state briefly delayed contributions to CalPERS [sic], an appellate court ruled in 1997 that orderly payments are needed to ensure an actuarially sound system to assure pension payments and “intergenerational taxpayer equity.”

The concept got a recent boost from new Governmental Accounting Standards Board rules for reporting pension debt. Investment losses should be paid off over five years and other actuarial changes should be paid off over the average time workers will remain on the job.
The “average remaining service life” the California Public Employees Retirement System calculated for its more than 2,000 state and local plans is four years. The California State Teachers Retirement System calculated an average remaining service life of seven years.

Ways to improve pension intergenerational equity have been suggested. A well-known pension expert, Girard Miller, suggested a transition beginning with a 20-year amortization or payment period and slowly moving to the average remaining service life.

A Pensions & Investments editorial ("Intergenerational Fairness," June 27, 2016) said public pension boards should have a representative of future generations and adopt the private-sector pension policy of paying off unfunded liabilities over seven years.

“Future generations must be protected from decisions contracted against their interests by the current generation. Keith P. Ambachtsheer in his book, ‘The Future of Pension Management,’ published this year, calls for a legal mechanism to secure such protection,” said the editorial accompanied by this cartoon.

The paper by the dissident actuaries emerged from a joint task force of the American Academy of Actuaries and the Society of Actuaries. The authors are Ed Bartholomew, Jeremy Gold, David G. Pitts, and Larry Pollack.

The paper written by long-time advocates of financial economics principles did not pass a peer review by the two actuarial groups and was not published, drawing criticism in the financial press. The Society of Actuaries released the paper later.

The main dispute is whether the principles of financial economics that apply to the rest of the world’s financial activities, including the capital markets, should also apply to public pension debt.

Traditional actuaries say pensions are an exception to financial economics because there is no regular market where pension debt, with complex risks such as longevity, is bought and sold.

Dissidents say there are other financial tools that can determine pension value and estimate the additional cost of a complex risk. The calculation may be less precise, but it’s not something that can’t be done.

Traditional actuaries tend to focus on avoiding budget-jolting shocks in the annual contribution rates that government employers pay for pensions, less on the debt or unfunded liability created when the rates and investment earnings fall short of the annual target.
Reformers and critics grounded in financial economics view a pension unfunded liability as a bond-like debt that must be paid off. Actuaries have a different view, citing another reason that pensions are an exception: Most governments can't go out of business, unlike corporate pension sponsors.

“I’ve spoken with numerous public-sector actuaries and plan administrators whose unshakeable mindset has been that their plans are perpetuities and therefore it’s reasonable to defray accumulated pension deficits (unfunded liabilities) over extended periods that have no relationship to the lives of the retirees and current workers,” Miller, the pension expert, said in a Governing magazine column on March 8, 2012.

That mindset resulted in the “open” or “rolling” amortization used by some public pensions to pay off unfunded liabilities. The debt is refinanced each year and theoretically might never be paid off, unless booming investment markets produce a period of full funding.

CalPERS has used “rolling” amortization in addition to spreading gains and losses over 15 years to avoid employer rate shocks and “smooth” contributions. It’s radical smoothing, far beyond the typical public pension smoothing period of three to seven years.

In a switch to a more conservative actuarial method resulting in a large employer rate increase, CalPERS adopted “direct rate smoothing” three years ago that pays off gains and losses over 30 years, with rates going up in the first five years and down in the last five years.

Actuaries want pension systems to be moving toward full funding, but getting there is not like paying off a bond. It’s only a projection over decades that employer-employee contributions and the forecast of investment earnings will cover projected pension costs.

CalPERS was 101 percent funded in 2007 and only 61 percent funded two years later in 2009. Heavy losses during the recession and stock market dropped the CalPERS investment fund from $260 billion to about $160 billion.

Not only is full funding a kind of mirage, when as with CalPERS risky investments are expected to cover two-thirds of pension costs, but it also can create political pressure to spend the “surplus” by cutting contributions and increasing pension benefits.

“Relatively small surpluses provide a cushion for benefits being earned (valuation timing) and for emerging gains and losses,” said the dissidents’ paper. “Large surpluses become fodder for the political process, with the current generation likely to increase benefits and/or take funding holidays.”

During the high-tech boom in the late 1990s, all three of the big state pension systems spent their funding “surpluses,” large and small, by cutting employer contribution rates and increasing pension benefits. (See Calpensions post, “What went wrong” 10 Jan 11)
Now despite a lengthy bull market since the recession, CalPERS as noted earlier is only about 68 percent funded. Experts say if funding drops below 40 percent, raising rates and earnings forecasts high enough to project 100 percent funding may become impractical.

Last November CalPERS adopted a strategy to slowly reduce investment risk by slightly dropping its earnings forecast in years with high returns. Some statistical modeling estimates the current 7.5 percent forecast could be lowered to 6.5 percent in two decades.

The strategy will slowly shift CalPERS investments away from stocks to less risky bond-like investments, probably resulting in a rate increase. For California pensions, the CalPERS risk strategy and the dissidents’ paper are a turn back toward the roots.

All pension fund investments had to be in bonds, or something similar, until voter approval of Proposition 1 in 1966 allowed 25 percent of investments to be in blue-chip stocks. Then Proposition 21 in 1984 allowed any “prudent” investment.

Turning back toward intergenerational equity would be costly and a reversal for lawmakers. Legislation 25 years ago (AB 1104 in 1991) created a pension-like investment fund for state worker retiree health care.

But lawmakers never put money in the fund as retiree health care became one of the fastest-growing state costs, creating a $74 billion unfunded liability. Gov. Brown is currently negotiating labor contracts that require state workers to begin contributing to the fund.

Cost containment was the announced goal last year when Brown said he would push prefunding for retiree health care. There was, however, at least one nod toward intergenerational equity as spending on state worker retiree health care neared $2 billion a year.

“Not setting aside funds for retiree health benefits earned during employees’ working lives violates a fundamental tenet of public finance — that costs should be paid in the year when they are incurred,” Legislative Analyst Mac Taylor said in his annual “fiscal outlook” issued in 2014.
An Annuity for the Teacher — and the Broker (New York Times, Your Money) 10-26-16

A look inside the high-pressure job of selling workplace annuities to public schoolteachers.

BY: Tara Siegel Bernard

Bradley Bergeron’s first professional job out of college was selling retirement savings investments to public schoolteachers in Connecticut. The applications he carried in his black leather briefcase, however, were for one type of product only: a high-priced variable annuity.

“From the teacher’s standpoint, they really miss out getting quality advice,” said Mr. Bergeron, 27, who sold the plans for Axa Advisors’ retirement benefits group. “People who are in the schools pitching them and positioning themselves as retirement specialists are really there just to sell them one product.”

Workers at private companies typically enroll in a 401(k) retirement plan approved by the employer, which is held responsible for the menu of investment options offered. But public school employees and people working for nonprofits and religious institutions are often exposed to brokers who operate in a more unruly marketplace under different rules, which are defined by a patchwork of state laws and less stringent securities regulations.

Brokers and insurance executives say it has become more difficult to walk into schools freely in recent years — the Los Angeles Unified School District, for instance, strictly forbids soliciting on campus. Brokers still find ways to win face time with teachers, however. Many schools allow them to make presentations for their 401(k)-style counterparts — known as 403(b) plans — at the end of faculty meetings. Or they might hang out in break rooms and provide free meals on professional development days.

“Teachers are still being preyed upon by salespeople,” said Dan Otter, founder of the advocacy and educational site 403bwise.com, and a longtime teacher now working at the University of New Mexico. “The problem is their first experience with a 403(b) is in a sales environment.”
At Axa — which has about $16.3 billion in 403(b) assets held for employees of elementary, middle or high schools — sales representatives often start the conversation with prospective clients using a so-called yellow pad presentation, several former brokers said, even if they don’t always have it written down on the yellow pads all teachers are familiar with.

Brokers are trained to start by explaining how a teacher’s state pension works, how the tax-advantaged 403(b) operates and what sort of gap might have to be filled with savings to help maintain the teacher’s standard of living in retirement. Many — even those who later became disenchanted with their jobs — said they believed they were helping teachers save and realize their long-term goals.

Only after setting the stage does the broker introduce the main performer. For Axa’s brokers, that role is usually assigned to Axa’s Equi-Vest variable deferred annuity. It isn’t simple: To get the full rundown on how it works, people must sift through a document that is 460 pages long.

And it doesn’t come cheap. The most popular version of the Equi-Vest annuity has a total annual cost that can range from 1.81 to 2.63 percent, according to an analysis from Morningstar.

In contrast, large 401(k) plans usually charge an annual fee of less than half a percent of assets, according to a May report by BrightScope using 2013 data. Large, federally regulated 403(b) plans charge a bit more.

“It is really designed for the experienced advisers to take advantage of the younger advisers’ enthusiasm,” said Mr. Bergeron, who left Axa in 2014 after a year and a half. He later held two short-lived jobs in the industry, but struggled financially. He has since decided to leave the field altogether.

“It was a mental drain working as an adviser,” he added. “I became a little depressed at the end of it and wanted nothing to do with it.”

Mr. Bergeron’s testimony is echoed by others. Several former brokers said they left Axa — and the 403(b) business over all — because they decided this was not the type of product they would sell to their own family members. Despite their misgivings, several sales representatives said they understood how some of their former colleagues justified selling high-fee products: If it
weren’t for us, they reason, many teachers would not be saving for retirement, beyond their pensions, at all.

Brian Jenkins, now a consultant for firms that raise money for start-up companies, shared that mind-set. He worked for more than 30 years in the media industry before joining Axa, where he covered the Barrington school district, in an affluent Illinois suburb where his children attended school, among others.

“Many school employees would have never taken the initiative to open a retirement account if I had not been there,” said Mr. Jenkins, who left Axa in 2014. “The fees that were built into the annuity product paid for a field staff of agents to go into the schools and reach out to people. I feel good about what I was able to do for them.”

He said he was always encouraged by his managers to be upfront about the various charges, which he fully disclosed to his customers, many of whom did not know what 403(b) options they had.

Still, those fees erode workers’ balances over time, leaving retirees with significantly smaller nest eggs.

Take an employee with a starting salary of $40,000 who saved 6 percent of her salary over a 40-year career. She would retire with about $175,000 when paying annual fees of 2 percent, assuming a 4 percent return after inflation, according to an analysis conducted by Vanguard. (The analysis also assumes that her salary rises 1 percent annually, also adjusted for inflation.)

But she would have 25 percent more, or a total of nearly $218,000, if fees had been 1 percent, and almost $260,000 if she paid 0.25 percent in fees.

Mat Burridge, a sixth-grade teacher in Hannibal, N.Y., said he had trouble untangling exactly how much he paid for his variable annuity from Voya (which invests in a collection of subaccounts similar to mutual funds). After several phone calls, he learned that he paid at least 1.2 percent for the annuity, in addition to the various fees for 15 underlying funds his broker chose.

After reading about how much that will cost him over time, he decided to stop contributing and redirect his savings into an I.R.A. at Vanguard, known for its rock-bottom costs. “It really hit home because we just refinanced our mortgage,” Mr. Burridge, 30, said. “You are talking a significant amount of money.”

Then there is the surrender fee. An Equi-Vest annuity owner who wants to transfer savings into another 403(b) product or roll it over into an I.R.A., for example, would pay 5 percent to Axa on any of the withdrawal that was contributed in the previous six years.

Axa said that annuity owners can withdraw up to 10 percent of their money without penalty annually, as long as it is permitted under the tax code, and that the fee can be waived for hardships and other reasons.
Beyond Axa, other large players in this market include Voya, Valic, Lincoln Financial Group and MetLife (whose retail adviser force was recently acquired by MassMutual), according to the retirement industry publication PlanSponsor. Last year, Axa sold roughly $2.2 billion worth of Equi-Vest annuities within retirement plans, according to Morningstar, which include different versions of the product.

The charges for such complex annuities are intended to provide plenty of incentive for sales representatives and their managers. At Axa, for example, a broker can earn roughly 5 to 7 percent of the total amount teachers deposit in their 403(b)'s for the first year (though some pocket only half that amount, a former broker said, depending on their pay structure).

In a statement, Axa said that it offered a range of approaches and products to meet each individual client’s needs, and that the company appropriately disclosed all benefits, risks, fees and restrictions. “The variable annuity product we make available in the 403(b) space offers guarantees not available in mutual funds or index funds,” an Axa spokesman said, “which can significantly reduce our clients’ exposure to market loss.”

Selling annuities also creates a continuing income stream for the brokers. Axa pays a commission of 1.5 percent to 2 percent on every future dollar an employee contributed to a 403(b) annuity. The annuity sold to the teacher, in a sense, becomes an annuity for the sales rep and the company’s managers.

While that translates into a healthy living for some brokers, many others are poorly compensated, dependent largely on commissions. This is particularly true for those fresh out of college.

Many of these practices are plainly stated on Axa’s website, including the fact that brokers are paid more to sell annuities than to sell mutual funds. Axa said that reflected the complexity of selling annuities.

To qualify for Axa’s health insurance plan and retirement benefits, moreover, brokers must sell a certain amount of proprietary insurance-related products, including annuities.

Justin Victor, a certified financial planner who left Axa in 2008 after three years, recalls the intensity of that pressure. “I am not going to lie,” he said. “When you have your health insurance on the line in the commission-based financial advisory world, you will do whatever you can to get a commission.”

Axa said certain tax rules required its insurance sales representatives to solicit and sell mostly insurance products, including annuities, so they could receive employer-provided benefits.

Axa managers take a healthy cut from the younger recruits they oversee, according to a former broker who spoke on the condition of anonymity because he feared repercussions from the firm. Figures can vary widely, but managers might earn, he said, up to 36 percent of a new broker’s commissions on proprietary products sold during the first three years of service.
“It is really designed for the experienced advisers to take advantage of the younger advisers’ enthusiasm,” said Mr. Bergeron, who left Axa in 2014 after a year and a half. He later held two short-lived jobs in the industry, but struggled financially. He has since decided to leave the field altogether.

“It was a mental drain working as an adviser,” he added. “I became a little depressed at the end of it and wanted nothing to do with it.”

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—Doris Burke contributed research.
Calstrs further reduces assets held by external fund managers (Investor Relations, Buy Side) 10-31-16

BY: Andrew Holt

https://www.irmagazine.com/articles/buy-side/21681/calstrs-further-reduces-assets-held-external-fund-managers/

Pension scheme looking at having 60 percent managed in-house

Calstrs [sic], the third-largest pension scheme in the US, is to further pull money from its external fund managers as part of an on-going strategy to reduce money held externally.

The Calstrs Investment Business Plan, published in July this year, shows the body’s intention to bring in-house assets to 50 percent over the next three years. As of June this year, Calstrs had 46 percent in-house, 54 percent external and oversight of $193 bn of assets.

Over the last year, it has brought $13 bn in-house. Over the longer term, Calstrs confirms to IR Magazine that it wants to manage 60 percent of assets in-house.

The business plan states a three-part investment process: ‘The first is to continue to integrate ESG and sustainability into the investment process, [then] expand the diversity of investment management, all the while seeking to keep costs down with expanded internal management.’

According to its latest annual report, the pension scheme’s largest external mandates are with Generation Investment Management – the London-based company that was co-founded by former US vice president Al Gore – New York-based Lazard Asset Management and CBRE Global Investors, the property investment specialist.

The number of investment staff employed by the pension fund has risen 15 percent to 155 over the past two years to deal with the increase in capital managed internally.

Calstrs’ latest annual report shows it paid $155.7 mn in investment fees in the year to the end of June 2015, nearly 10 percent less than it paid in fees the previous year. The fee intake of investment managers Morgan Stanley, T Rowe Price and Aberdeen Asset Management all fell significantly in that period, by 61 percent, 24 percent and 15 percent, respectively.
WHAT WE CAN LEARN FROM NORWAY ABOUT RETIREMENT (Forbes, Next Avenue Blog) 11-06-16

BY: Chris Farrell, Next Avenue Contributor


During his first TV debate with Hillary Clinton for the Democratic nomination, Sen. Bernie Sanders remarked: “We should look to countries like Denmark, like Sweden and Norway and learn from what they have accomplished for their working people.” Clinton didn't buy it. “We are not Denmark,” she replied. “I love Denmark. We are the United States of America, and it’s our job to rein in the excesses of capitalism so it doesn’t run amok.”

Of course, Clinton’s right; the U.S. isn’t Denmark, or Norway or Sweden. But that doesn’t mean we shouldn’t learn from public policies that work there (or anywhere else) and see if they’re worth adopting here. Case in point: retirement.

In the past few years, Norway, in particular, has made a few smart changes to its retirement system that have been a huge help to its residents and to its employers. Norway was No. 1 in the 2016 Natixis Global Retirement Index, a data-driven ranking of retirement security in 43 countries that my Next Avenue colleague, Richard Eisenberg wrote about in July.

Pensions: Common in Norway, But Not Here

In Norway — as well as Sweden, Denmark, Germany and the rest of the major industrial nations — public- and private-sector workers are covered by some kind of pension. Yet in the U.S., about half of corporate employees lack access to an employer-sponsored retirement plan.

“When I go to conferences in Europe and I tell them that half of American workers don’t have pensions they’re shocked,” says Anthony Webb, research director of the Retirement Equity Lab at the Schwartz Center for Economic Policy at the New School for Social Research.

Norway has a government-provided retirement pension along the lines of Social Security. But in 2011, the country did something pretty clever that went beyond it. Norway overhauled its private-sector pension system known as AFP to encourage older Norwegians to stay employed.

How Norway Improved Its Retirement System

Most Norwegian companies are required to provide AFP pensions to workers in retirement. But before 2011, those workers could retire between age 62 and 67, the size of their AFP pension benefits depended on their employment earnings (means testing) and there was no financial reward to postpone receiving the benefits until age 67. No surprise, most workers started taking their pensions around age 62.
Starting in 2011, however, the AFP pension benefit was no longer means-tested based on employment earnings, so Norwegians wouldn’t be penalized if they wanted to keep working while earning retirement benefits. And the size of the pension now grows each year a worker delays filing to claim it, until age 75. (You can learn more about this by reading the research paper, “How Does Retirement Behavior Respond to Drastic Changes in Social Security Rules? Lessons from the Norwegian 2011 Pension Reform” by economists Christian Brinch of Norwegian Business School, Ola Vestad of University of Chicago and Statistics Norway and Josef Zweimüller of University of Zurich).

So what was the result of these reforms? The percentage of AFP-eligible workers who claimed benefits at 62 rose from 30% to 50%, but the fraction who continued working after claiming at 62 shot up by about 13%.

In other words, the traditional connection between the decision to file for a pension and to stop working was severed. Welcome to the new world of unretirement.

“The most important lesson is when you remove the earnings test and give people flexibility over when to start their benefits, people are much more likely to continue working past their early retirement date,” said co-author Vestad. “People seem to appreciate the opportunity to take their benefit and continue working.”

**Retiring as a Norwegian Would**

I see two lessons from the Norwegian experience for the U.S.:

First, the desire to file early for retirement money is powerful, but that doesn’t mean people want to leave the job market when they get the cash.

Almost 40% of U.S. workers claim Social benefits as soon as they can — at 62. Yet an analysis by the Economic Policy Institute (EPI) found that not all workers claiming the benefits before their Full Retirement Age of 66 leave the job market. In a 2011 study, EPI economist Monique Morrissey estimated that nearly half of individuals and married couples age 62 to 64 also had earnings from work and those earnings made up nearly one-fourth of their income. "Many people use retirement benefits to supplement income from a full- or part-time job and therefore are not ‘retired’ in the conventional sense,” wrote Morrissey.

Second, the Norwegian experience suggests to me that retirement money in the U.S. should be designed with an eye toward supporting phased retirement, or what I call unretirement.

For example, retirement experts have been eyeing a number of potential changes to let people collect some of their employer-sponsored pensions while working part-time. (The federal government has a new phased retirement program along these lines.)

Eliminating the Social Security earnings test could be another helpful move. The earnings test — which withholds a portion of your benefits if your earnings exceed $15,720 in 2016 and you're claiming before normal retirement age — exacts an unnecessary financial penalty for those who need to supplement their work income in their early 60s.
Combining a universal 401(k) or an IRA for all workers with improved Social Security payouts is an efficient solution.

**Who Wants to Work in Retirement**

In a series of detailed studies, Joseph Quinn, economics professor at Boston College, Kevin Cahill, research economist with the Sloan Center on Aging and Work at Boston College and Michael Giandrea, economist at the U.S. Bureau of Labor Statistics have documented that a majority of older Americans earn an income in their so-called retirement years. The scholars note that these people typically reduce the number of hours worked, change employers later in life, reenter the labor market after an initial period of retirement and, in many cases, follow some combination of those three paths.

Their research also shows how older workers prefer part-time work. They found the prevalence of part-time bridge employment to retirement was highest among those age 71 to 81 —52% of men and 64% of women that age. The lowest percentage of part-timers was among younger boomers, age 59 to 64 —26% of men and 39% of women.

In other words, stop thinking that working older Americans are the exception. They’re the new normal.

Think Norway! The growing popularity of unretirement in the U.S. means policy makers should recognize that more people will want to combine work income and retirement savings to support themselves well past 62. When it comes to reforming Social Security, pensions and retirement savings, the mantras should be “universal,” “flexible” and “choice.”
The California State Teachers’ Retirement System (CalSTRS) is considering a plan to launch as many as four internally managed enhanced index investments ranging from $200 million to $500 million each, CIO Chris Ailman says.

The move comes as a result of dissatisfaction with the correlation between externally managed enhanced indexes as well as their fees, he says. After terminating numerous enhanced index managers in recent years, CalSTRS may look to run internally-managed strategies that focus on governance, sustainability, gender diversity and various factor tilts, Ailman says.

The move would build on several trends within and outside of CalSTRS including the growth of internal management, the use of environmental, social and governance (ESG) factors and fee sensitivity.

"Over the years we’ve had some disappointment with some of our external enhanced index managers," Ailman says. "It’s much less expensive to do that internally than to go out and hire even more people. The big push for internal management, at its core, is about fee reductions and cost reductions."

In April, CalSTRS announced an internally managed $2.5 billion low-carbon index which will be larger than any internally managed enhanced indexes that CalSTRS is considering, Ailman says.

Money from both active and passive managers will contribute to the enhanced index project.

Enhanced indexes have struggled in recent years with $52.6 billion in net outflows for the three years period ending Oct. 30, according to eVestment.

CalSTRS is still in the process of implementing major changes to its asset allocation that it approved last year, including a change that shifted the U.S. equities allocation to 24% from 37%. As part of changes to the portfolio, CalSTRS plans to take approximately $20 billion away from its external managers, increasing the internally managed portion to 60% from 50%.

And CalSTRS is not alone in shifting to internal management. The $55 billion Alaska Permanent Fund is increasing its internally managed portfolio to 50% from 24% over the next five years and the North Carolina Retirement System is also examining ways to increase its internal management, as reported.

CalSTRS is also looking for active managers and recently issued a request for information (RFI) for sustainable strategies.

The RFI is the first of its kind in ten years and is not designed for any specific mandate, but rather to determine the available market for ESG public equity products for future investment, Ailman says.
"I've had some big traditional managers come and tell me that they've actually had an ESG product for three or four years and I had no idea," he says. "It's a good chance to test the water and find everyone who's out there. That will really tell us the opportunity size and from there we'll determine how to size that portfolio."

Fee pressure has already led many institutions away from active management toward enhanced indexes, and that same fee pressure has been applied to enhanced indexes, says Eugene Podkaminer, senior v.p. in the capital markets research group at Callan Associates.

"In general, there’s been fee pressure downwards by investors and that’s true across product offerings, not just smart beta," he says.
CalSTRS says 85% of management fees in 2015 went to private markets (Pensions & Investments, News & Opinion) 11-10-16

BY: Randy Diamond


CalSTRS spent $935 million in external management fees in the 2015 calendar year, the largest chunk of it, $796 million, attributed to private markets firms, shows a report to be presented at the pension fund's Nov. 16 investment committee meeting.

The report is the first time the $193.2 billion West Sacramento-based pension plan has disclosed full private equity fees including carried interest. The report says 39% of the total fees paid by CalSTRS is attributable to carried interest.

Public market investment fees amounted to a much smaller $139 million, the report said.

“Private assets are complex and require a higher degree of expertise, resulting in higher costs,” the report noted.

Overall, total costs of managing CalSTRS investments, including internal costs, came to $1.5 billion, up from the $963 million in the 2014 calendar year. However, the 2014 figures did not include some $320 million in net partnership expenses and other fees, according to the report.

The California State Teachers' Retirement System has a $16 billion private equity program, one of the largest in the U.S. by an institutional investor.

The issue of how much pension funds are paying in fees to private equity firms became part of a controversy in 2015 when the $300.5 billion California Public Employees' Retirement System, Sacramento, first disclosed it was unable to say how much in carried interest, or performance fees, it was paying for its private equity program.

California Gov. Edmund G. “Jerry” Brown Jr. signed legislation into law in September that requires CalPERS and CalSTRS to disclose both management and performance fees for private equity.
ERA OF LOW INTEREST RATES HAMMERS MILLIONS OF PENSIONS AROUND WORLD
(Wall Street Journal, Markets) 11-13-16

Central-bank moves pull down returns for government-run funds, making it difficult to meet mounting obligations to workers and retirees

BY: Timothy W. Martin, Georgi Kantchev and Kosaku Narioka


Central bankers lowered interest rates to near zero or below to try to revive their gasping economies. In the process, though, they have put in jeopardy the pensions of more than 100 million government workers and retirees around the globe.

In Costa Mesa, Calif., Mayor Stephen Mensinger is worried retirement payments will soon eat up all the city’s cash. In Amsterdam, language teacher Frans van Leeuwen is angry his pension now will be less than what his father received, despite 30 years of contributions. In Tokyo, ex-government worker Tadakazu Kobayashi no longer has enough income from pension checks to buy new clothes.

Managers handling trillions of dollars in government-run pension funds never expected rates to stay this low for so long. Now, the world is starved for the safe, profitable bonds that pension funds have long needed to survive. That has pulled down investment returns and made it difficult for funds to meet mounting obligations to workers and retirees who are drawing government pensions.

As low interest rates suppress investment gains in the pension plans, it generally means one thing: Standards of living for workers and retirees are decreasing, not increasing.

“Unless ordinary people have money in their pockets, they don’t spend,” the 70-year-old Mr. Kobayashi said during a recent protest of benefit cuts in downtown Tokyo. “Higher interest rates would mean there’d be more money at our disposal, even if slightly.”
The low rates exacerbate cash problems already bedeviling the world’s pension funds. Decades of underfunding, benefit overpromises, government austerity measures and two recessions have left many retirement systems with deep funding holes. A wave of retirees world-wide is leaving fewer active workers left to contribute. The 60-and-older demographic is expected to roughly double between now and 2050, according to the United Nations.

Government-bond yields have risen since Donald Trump was elected U.S. president, though few investors expect a prolonged climb. Regardless, the ultralow bond yields of recent years have already hindered the most straightforward way for retirement funds to recover—through investment gains.

Pension officials and government leaders are left with vexing choices. As investors, they have to stash away more than they did before or pile into riskier bets in hedge funds, private equity or commodities. Countries, states and cities must decide whether to reduce benefits for existing workers, cut back public services or raise taxes to pay for the bulging obligations.

“Interest rates have never been so low,” said Corien Wortmann-Kool, chairwoman of the Netherlands-based Stichting Pensioenfonds ABP, Europe’s largest pension fund. It manages assets worth €381 billion, or $414 billion. “That has put the whole system under pressure.” Only about 40% of ABP’s 2.8 million members are active employees paying into the fund.

Pension funds around the world pay benefits through a combination of investment gains and contributions from employers and workers. To ensure enough is saved, plans adopt long-term annual return assumptions to project how much of their costs will be paid from earnings. They range from as low as a government bond yield in much of Europe and Asia to 8% or more in the U.S.

The problem is that investment-grade bonds that once churned out 7.5% a year are now barely yielding anything. Global pensions on average have roughly 30% of their money in bonds.

Low rates helped pull down assets of the world’s 300 largest pension funds by $530 billion in 2015, the first decline since the financial crisis, according to a recent Pensions & Investments and Willis Towers Watson report. Funding gaps for the two biggest funds in Europe and the U.S. have ballooned by $300 billion since 2008, according to a Wall Street Journal analysis.

Few parts of Europe are feeling the pension pain more acutely than the Netherlands, home to 17 million people and part of the eurozone, which introduced negative rates in 2014. Unlike
countries such as France and Italy, where pensions are an annual budget item, the Netherlands has several large plans that stockpile assets and invest them. The goal is for profits to grow faster than retiree obligations, allowing the pension to become financially self-sufficient and shrink as an expense to lawmakers.

ABP currently holds 90.7 cents for every euro of obligations, a ratio that would be welcome in other corners of the world. But Dutch regulators demand pension assets exceed liabilities, meaning more cash is required than actually needed.

This spring, ABP officials had to provide government regulators a rescue plan after years of worsening finances. ABP’s members, representing one in six people in the Netherlands, haven’t seen their pension checks increase in a decade. ABP officials have warned payments may be cut 1% next year.

“People are angry, not because pensions are low, but because we failed to deliver what we promised them,” said Gerard Riemen, managing director of the Pensioenfederatie, a federation of 260 Dutch pension funds managing a total of one trillion euros.

Benefit cuts have become such a divisive issue that one party, 50PLUS, plans for parliamentary-election campaigns early next year that demand the end of “pension robbery.”

“Giving certainty has become expensive,” said Ms. Wortmann-Kool, ABP’s chairwoman.

That is tough to swallow for Mr. van Leeuwen, the Amsterdam language teacher. Sitting on a bench near one of the city’s historic canals, he fumed over how he had paid the ABP every month for decades for a pension he now believes will be less than he expected.

Japan is wrestling with the same question of generational inequality. Roughly one-quarter of its 127 million residents are now old enough to collect a pension. More than one-third will be by 2035.

The demographic shift means contributions from active workers aren’t sufficient to cover obligations to retirees. The government has tried to alleviate that pressure. It decided to
gradually increase the minimum age to collect a pension to 65, to require greater contributions from workers and employers and to reduce payouts to retirees.

A typical Japanese couple who are both 65 would collect today a monthly pension of ¥218,000 ($2,048). If they live to their early 90s, those payouts, adjusted for inflation, would drop 12% to ¥192,000.

The Japanese government has turned to its $1.3 trillion Government Pension Investment Fund for cash injections six of the past seven years. That fund, the largest of its kind in the world, manages reserves for Japan’s public-pension system and seeks to earn returns that outpace inflation. The more it earns, the more it can shore up the government’s pension system.

In February, Japanese central bankers adopted negative interest rates for the first time on some excess reserves held at the central bank so commercial banks would boost lending. The pension-investment fund raised a political ruckus in August when it said it lost about ¥5.2 trillion ($49 billion) in the space of three months, the result of a foray into volatile global assets as it tried to escape low rates at home.

The fund’s target holdings of low-yielding Japanese bonds were cut to 35% of assets, from 60% two years ago, and it has added heaps of foreign and domestic stocks. It is now considering investing more in private equity.

The government-mandated target is a 1.7% return above wage growth. “We’d like to strive to accomplish that goal,” said Shinichiro Mori, a deputy director-general of the fund’s investment-strategy department.

The fund posted a loss of 3.8% for the year ended in March because of the yen’s surge and global economic uncertainty. It was its worst performance since the 2008 global financial crisis. Mr. Mori said performance “should be evaluated from a long-term perspective,” citing returns of ¥40 trillion ($376 billion) since 2001.

Mr. Kobayashi, the former Tokyo government worker, said the government’s effort to boost returns by making riskier investments was supposed to “increase benefits for everyone, even if only slightly. It didn’t turn out that way…And they are inflicting the loss on us.”

Mr. Kobayashi joined roughly 2,300 people who marched in downtown Tokyo in October to protest government plans to cut pension benefits further.

In the U.S., the country’s largest public-pension plan is struggling with the same bleak outlook. The California Public Employees’ Retirement System, which handles benefits for 1.8 million members, recently posted a 0.6% return for its 2016 fiscal year, its worst annual result since the financial crisis. Its investment consultant recently estimated that annual returns will be closer to 6% over the next decade, shy of its 7.5% annual target.

Calpers [sic] investment chief Ted Eliopoulos’s strategy for the era of lower returns is to reduce costs and the complexity in the fund’s $300 billion portfolio. He and the board decided to pull out
of hedge funds, shop major chunks of Calpers’ real-estate and forestry portfolios and halve the number of external money managers by 2020.

“Calpers isn’t taking a passive approach to the anticipated lower return rates,” fund spokeswoman Megan White said. “We continue to reassess our strategies to improve performance.”

Yet the Sacramento-based plan still has just 68% of the money needed to meet future retirement obligations. That means cash-strapped cities and counties that make annual payments to Calpers could be forced to pay more.

That is a concern even for cities such as affluent Costa Mesa in Orange County, which has a strong tax base from rising home prices and a bustling, upscale shopping center.

The city has outsourced government services such as park maintenance, street sweeping and the jail, as a way to absorb higher payments to Calpers. Pension payments currently consume about $20 million of the $100 million annual budget, but are expected to rise to $40 million in five years.

The outsourcing and other moves eliminated one-quarter of the city’s workers. The cost of benefits for those remaining will surge to 81 cents of every salary dollar by 2023, from 37 cents in 2013, according to city officials.

The mayor, Mr. Mensinger, is hopeful for a state solution involving new taxes or a benefits overhaul, either from lawmakers in Sacramento or from a California ballot initiative for 2018 that would cap the amount cities pay toward pension benefits for new workers.

Weaker cities across California could face bankruptcy without help, said former San Jose Mayor Chuck Reed, who oversaw a pension overhaul there in 2012 and is backing the 2018 initiative that would shift onto workers any extra cost above the capped levels. “Something is broken,” he said. “The plans are all based on assumptions that have been overly optimistic.”

Costa Mesa resident James Nance, 52, worries the city’s pension burden will affect daily life. “We could use more police,” said the self-employed spa repairman. “I’d like to know the city is safe and well protected, but I know there have been tremendous cutbacks.”

Costa Mesa ended the latest fiscal year with an $11 million surplus, its largest ever. But that will soon disappear, Mr. Mensinger said, as pension costs swallow up $2 of every $5 spent by the city.

“We have this gigantic overhead cliff called pensions.”