BILL NUMBER: H.R. 6290 (Nunes) as introduced June 28, 2018

SUMMARY

H.R. 6290 requires a state or local government applicable retirement plan sponsor to report specified plan information to the U.S. Treasury Secretary each plan year beginning on or after January 1, 2019, including the value of plan liabilities using the U.S. Treasury spot rate yield curve—often described as a “risk free” rate of return. Failure to comply with the reporting requirements results in the forfeiture of federal tax benefits to bonds issued by the relevant state or political subdivision until noncompliance is remedied. H.R. 6290 also directs the Secretary to create and maintain a public website to post the required information and specifies that the U.S. government will not be liable for obligations related to current or future shortfalls in state or local government applicable retirement plans.

BOARD POSITION

Oppose. Creating a different means of measuring the liabilities of CalSTRS programs will cause confusion among members and the general public. It is the policy of the board to adopt an oppose position on legislation that adversely affects the actuarial balance of the funds administered by CalSTRS. Although this bill does not directly affect the actuarial balance of the funds administered by CalSTRS, it does affect the *perception* of the actuarial balance of the funds.

REASON FOR THE BILL

The financial status of state or local government applicable retirement plans and the extent to which these plans are underfunded is asserted by the legislation’s sponsors to be obscured by opaque and deceptive governmental accounting practices, resulting in the perceived misstatement of plan asset values and understatement of plan liabilities.

ANALYSIS

Existing Law:

Congress has the authority pursuant to clauses 1 and 3 of Section 8 of Article 1 of the Constitution of the United States to levy taxes. This authority includes the ability to establish conditions upon which special federal tax benefits are granted, including certain specified tax benefits for state and local government retirement plans. The Internal Revenue Code (IRC) is the body of law that codifies all federal tax laws, including specified federal tax benefits. Bonds issued by a state or any of its political subdivisions are generally exempt from federal income tax.

This Bill:

Specifically, H.R. 6290:

- Requires a state or local government applicable retirement plan sponsor to report to the U.S. Treasury Secretary each plan year beginning on or after January 1, 2019, and no later than 210 days after the end of the plan year:

- The plan liability, the value of plan assets, the net unfunded liability and the funding percentage of the plan;
- The schedule of contributions for the plan year;
- Projections for each of the 60 subsequent plan years of the cash flows associated with the plan liability;
- Actuarial assumptions, including the assumed rate of return on investments and other assumptions the Secretary may specify by regulation;
- The number of active, inactive and retired plan participants;
- Investment returns, including the plan year and each of the five preceding plan years;
- An explanation of the plan's funding policy, the degree to and manner in which any unfunded liability for the plan year is expected to be eliminated, and the extent to which the plan sponsor has followed the policy for each of the five preceding plan years;
- The amount of pension obligation bonds outstanding;
- The current cost of the plan for the plan year; and
- The plan's administrative and investment expenses.

- Requires forfeiture of federal tax benefits to bonds issued by the relevant state or political subdivision for failure to comply until noncompliance is remedied;
- Requires a supplemental report using required valuation methods and calculation assumptions if a pension plan does not value assets utilizing fair market value, does not calculate liabilities assuming a discount rate based on the U.S. Treasury spot rate yield curve; or does not determine the present value of an accrued benefit by discounting future cash flows using the U.S. Treasury spot rate yield curve and using the unit credit funding method; and
- Directs the Secretary to create and maintain a public website to post the required information and specifies that the U.S. government will not be liable for obligations related to current or future shortfalls in state or local government applicable retirement plans.

The keystone of H.R. 6290 is the consequence if state or local government applicable retirement plan sponsors do not comply with the financial reporting deadline and requirements—specifically, the forfeiture of federal tax benefits to bonds issued by the sponsor. Although CalSTRS does not issue bonds, the law would apply the federal tax benefit forfeiture to bonds issued by the State of California, seriously jeopardizing its ability to issue bonds.

The valuation and calculation assumptions specified by H.R. 6290 will create confusion for stakeholders and the general public when they attempt to evaluate the financial status of CalSTRS. The confusion arises from the four different numbers produced to describe the financial status of CalSTRS—the number adopted in the actuarial valuation, the number that would be reported to the Secretary, the number generated under the GASB requirements and the number generated under Moody's approach.

For example, as it pertains to valuing assets, CalSTRS currently utilizes a three-year smoothing method for its actuarial funding calculations, whereas H.R. 6290 stipulates that the fair market value method also be reported to the Secretary. As it pertains to calculating liabilities, CalSTRS currently assumes a rate of 7 percent to discount liabilities—a rate adopted by the board—whereas H.R. 6290 stipulates that the calculation of liabilities also assume a discount rate based on the U.S. Treasury spot rate yield curve. This requirement would artificially inflate plan liabilities by discounting them at the “risk free” rate of return on U.S. Treasury obligations, rather than the 7 percent return from a diversified investment portfolio utilized by CalSTRS. Valuing assets and calculating liabilities with varying methods and assumptions will yield starkly different results, particularly when applied to a portfolio the size of CalSTRS. Should H.R. 6290 pass, significant ongoing communication would be required for members, other CalSTRS stakeholders and the general public to clarify the complicated differences in financial reporting.

LEGISLATIVE HISTORY

H.R. 4822 (Nunes-CA, 2016); H.R. 1628 (Nunes-CA, 2013)/S. 779 (Burr-NC, 2013); H.R. 567 (Nunes-CA, 2011)/S. 347 (Burr-NC, 2011); H.R. 6484 (Nunes-CA, 2010), among other provisions, would have required state and local government employee pension plan sponsors to report specified financial data to the U.S. Secretary of the Treasury each plan year, utilizing a “risk free rate of return” to discount plan liabilities. Failure to comply with the reporting requirements would have resulted in the forfeiture of federal tax benefits to bonds issued by the state or political subdivisions for which the plan provides benefits until noncompliance is remedied. The House measures died in the House Ways and Means Committee, and the Senate measures died in the Senate Finance Committee.

PROGRAM BACKGROUND

The financial health of state and local government employee pension plans persists as a topic of public debate. Increasingly dated studies by a small handful of academics that challenge and attempt to discredit the traditional methods by which public pension plans measure solvency continue to fuel the rhetoric, causing some lawmakers—under the guise of greater financial transparency—to propose legislation that mandates the calculation of plan funding status and liabilities using a “risk free” rate of return as the discount factor. This approach artificially inflates plan liabilities when compared to the accepted methods prescribed by the rigorous actuarial, governmental accounting and legal standards already in place.

H.R. 6290 is cited as *The Public Employee Pension Transparency Act*. The bill aims to create an environment where all public pension plans would be evaluated using one-size-fits-all valuation methods and calculation assumptions, but those methods and assumptions seriously understate plan funding status by artificially inflating plan liabilities. The author has proposed nearly identical bills, all of which died in committee, each congressional session since 2010. Data on CalSTRS funding status—determined using a range of alternative discount rates for valuing liabilities—contribution schedules, plan participants, historical investment returns and other information specified by the bill are already reported through actuarial valuations and audited financial statements (prepared in accordance with Actuarial Standards of Practice and Governmental Accounting Standards Board accounting and financial reporting standards).

Currently, CalSTRS reports plan information annually to the State Controller’s Office, including plan membership, contributions, actuarial economic assumptions, amortization methods and funding progress. California public employee retirement systems are required to furnish audited financial statements to the Controller on an annual basis, and an actuarial valuation for defined benefit plans must be filed with the Controller at least every three years. The required reporting allows for periodic and independent analysis of the financial transactions of each public retirement system and allows the Controller to make comparisons between plans and evaluate their financial condition. The Controller, in turn, publishes an annual report that serves as a reference source for persons concerned with the status and adequacy of funding for public retirement systems in California.

In August 2012, GASB published new accounting standards that marked the most significant changes to the financial reporting of public pension plans in a generation. GASB 67 altered financial reporting for pension plans, while GASB 68 modified reporting requirements for plan employers. Under the new requirements, a government plan can discount pension liabilities using the expected rate of return on investments until it reaches a crossover point—the point when projected benefit payments for current employees and inactive employees exceeds the projected funding. If the crossover point is reached, benefit payments projected to be made from that point forward are to be discounted using a lower rate equal to the high-quality municipal bond interest rate. Although the new requirements are intended to improve the transparency, consistency and comparability of pension plan financial statements, they currently represent a second set of numbers associated with CalSTRS funding levels that members, other CalSTRS stakeholders and the general public would have to absorb.

Furthermore, in April 2013, Moody's Investor Services, a private firm that opines on the credit risk of debt obligations outlined its new approach to adjusting the pension assets and liabilities of states and local governments for the purpose of evaluating pension risk for independent credit ratings. Moody's cited a need to bring greater transparency and consistency to the analysis of pension liabilities as the impetus for its new approach. Moody's noted that the incorporation of these pension adjustments into its credit-rating methodology will have no immediate impact on state credit ratings—because of its self-proclaimed "strong" existing qualitative understanding of the pension-related credit pressures facing states—and estimates less than 2 percent of the total population of its general obligation and related ratings will be placed under review for possible downgrade. CalSTRS does not issue debt and does not seek guidance from Moody's on pension asset and liability reporting, but Moody's new approach toward adjusting government pension obligations has tangential effect on CalSTRS by introducing yet another set of numbers of plan funding available for public intake and comparison.

FISCAL IMPACT

Program Cost – None.

Administrative Costs/Savings – Additional financial reporting using alternative methods and assumptions would need to be generated for the federal government. Other costs for reporting and communicating the information are expected to be minor.

SUPPORT

None known.

OPPOSITION

CalSTRS
American Federation of State, County and Municipal Employees
County Executives of America
Government Finance Officers Association
International Association of Fire Fighters
International City/County Management Association
International Public Management Association for Human Resources
National Association of Counties
National Association of Police Organizations
National Association of State Auditors Comptrollers and Treasurers
National Association of State Retirement Administrators
National Association of State Treasurers
National Conference on Public Employee Retirement Systems
National Conference of State Legislatures
National Conference of State Social Security Administrators
National Council on Teacher Retirement
National Education Association
National League of Cities
National Public Employer Labor Relations Association
United States Conference of Mayors

ARGUMENTS

Pro: Assumed comparability of the financial health of sponsors amongst all plans.

Con: Presents excessive financial data that can be confusing and lead to erroneous conclusions about the true funding status of the plan when compared to financial reporting already being done in accordance with existing accounting and legal standards.

Establishes counterproductive federal intrusion on governmental plan funding, which has not been subject to federal mandates and regulation.

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