Multiemployer Plan Legislation Advances in House

Legislation to address the impending insolvency of a number of union multiemployer pension plans has cleared two Committees and appears to be headed toward a House floor vote later this month. But it has been called “dead on arrival” in the Senate by GOP opponents. So far, no efforts to add harmful public pension provisions have surfaced. Yet.

H.R. 397 -- often referred to as the Butch Lewis Act in honor of a deceased beneficiary of the Teamsters’ Central States Pension Plan, the largest of the approximately 130 multiemployer pension funds that are severely underfunded -- was voted out of the House Ways and Means Committee on July 10 on a party line vote of 25 yeas to 17 nays. A similar version of the bill had previously been approved by the House Education and Labor Committee on June 11, also along party lines. Ways and Means Committee Chairman Richard Neal (D-MA) said he expects the legislation will pass the full House by the end of July.

The bill would create the Pension Rehabilitation Administration (PRA) and a related trust fund within the Treasury Department to make loans to multiemployer plans in critical and declining status. Qualifying plans would be able to borrow funds needed to remain solvent, with the funds for these loans and the cost of running the program coming from the sale of Treasury-issued bonds sold on the open market to large investors, such as financial firms.

Multiemployer plans eligible to receive such a loan would include those:
- in critical and declining status as of the date of enactment or for which a suspension of benefits has been approved as of such date under current law;
- in critical status as of the date of enactment, with a modified funded percentage of less than 40 percent and a ratio of active to inactive participants which is less than 2-to-5; or
- that became insolvent after December 16, 2014, and have not been terminated.

The amount of any loan would generally be the amount needed to purchase annuity contracts or to implement a portfolio (or a combination of the two) sufficient to provide benefits to participants and beneficiaries of the plan in pay status, and terminated vested benefits, at the time the loan is made. The loan terms generally would require
the plan to make interest payments for 29 years with final interest and principal repayment due in year 30. The bill also includes an incentive for early repayment. Finally, a plan could also apply for financial assistance from the Pension Benefit Guarantee Corporation (PBGC) in conjunction with a PRA loan, but only if that plan can demonstrate a PRA loan alone will not allow the plan to maintain solvency or become solvent.

However, no specific amendment was offered to address public plans during the mark-up of the multiemployer plan bill, nor was there an amendment offered to impose a PEPTA-like prohibition on bailing out public pensions.

“It do not believe public pensions are out of the woods yet when it comes to the use of the multiemployer legislation as a possible way to impose new Federal restrictions on public pensions,” said Maureen Westgard, NCTR’s Executive Director. “NCTR will continue to monitor the situation and keep our membership closely informed if the multiemployer legislation does begin to advance in the Senate,” Westgard concluded.

- **HR 397, “The Rehabilitation for Multiemployer Pensions Act of 2019”**
- **Ways and Means Committee: “Neal Opening Statement at Markup of Multiemployer Pensions Legislation”**
- **House Ways and Means Committee Minority: “Brady Opening Statement at Full Committee Markup of Multiemployer Pension Legislation”**
- **National Association of Plan Advisors: “Multiemployer Pension Fix Continues to Work its Way Through the House”**
- **Forbes: “Trump to Sign Union Pension Plan Fix by Dec. Predicts Ways & Means Chair, But Lead GOPer Not So Sure”**
- **The Heritage Foundation: “Senate Resolution Cautions Against Federal Bailout of Fiscally Irresponsible States”**
- **The Neighbor: “U.S. Senate Resolution Warns Against Any Federal Bailout of State Pensions”**

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**Employee Benefit Trends**

Public employers know the value of retirement benefits in order to attract and retain highly qualified employees. But, as the labor market grows increasingly competitive, what are government employers facing as others—particularly in the private sector—enhance their employee benefits in order to recruit and hold onto high-potential employees?

The 2019 Employee Benefits Survey, administered by SHRM, the Society for Human Resource Management, was conducted March 31 to April 30, 2019, with a random sample of SHRM members. Its purpose was to assess the prevalence of more than 250 benefits, with human resource professionals being asked whether their organizations formally offered each benefit.

The survey received 2,763 responses, and the report based on these results was released June 25. This report also provides data on the prevalence of benefits over the past five years.

In general, employers were found to more likely increase offerings in all benefits categories than to decrease offerings. In fact, no more than three percent of organizations decreased benefits in any category since 2018. Furthermore, although benefits changed relatively little between 2018 and 2019, the survey found there were impacts on the benefits landscape from rising health insurance costs, the competition for talent, the multi-generational workforce, and the Tax Cuts and Jobs Act of 2017. Health-related benefits and wellness benefits saw the greatest increases across employers surveyed, with 20 percent of employers indicating they increased offerings
in those areas. However, while health-related benefits offerings were increased by 20 percent of employers, regardless of size, wellness benefits were more likely to be increased by large employers (500 employees or more) than by small employers (1-99 employees). For example, a quarter of employers with 500 or more employees increased wellness benefits since 2018, but only 13 percent of employers with fewer than 99 employees increased wellness benefits.

The report found that several factors are shaping the current benefits landscape:

- **Health Insurance Costs.** The cost of health insurance coverage for employers and employees continues to increase, with average family health insurance premiums increasing twice as fast as workers’ earnings and three times as fast as inflation since 2008. The results have been a shift to health insurance plans with more responsibility placed on employees, such as high-deductible health plans. Furthermore, the report finds employers’ decision-making on total benefits packages is often dominated by health insurance costs.

- **Competition for Talent.** With a tight talent market, wage growth is occurring, but employers “remain cautious about increasing wage and salary compensation, and some choose to diversify benefits offerings in lieu of paying higher wages,” the report says.

- **Tax Cuts and Jobs Act of 2017.** Several benefits were affected by the new law. For example, the loss of the business deduction for transportation benefits organizations offer to employees may be one of the driving factors in increases in telecommuting, the report suggests. Also, with reimbursement for moving expenses now required to be reported as income by employees, the real value of moving benefits for employees and the appeal of moving benefits as a recruiting tool have been reduced.

- **The Multi-Generational Workforce.** Employees in different life stages may want and need different benefits. “While employers cannot afford to offer the best of every benefit, they can ill afford to under-invest in the benefits that are most important to their employees,” the report stresses. Hence the diversity of available benefits, demonstrating organizations understand that they must be creative in allocating resources toward those benefits that have the greatest impact on each employee.

The report is broken into five broad areas, as follows:

1. **Healthcare and Health Services Benefits.** Eighty-six percent of employers that responded to the survey believe health-related benefits are very important or extremely important to their workforce, and only three percent of employers have reported a decrease in these benefits. Twenty percent have made their health-related benefits more generous in the last 12 months, and 70 percent reported their health benefits have stayed the same. Eighty-five percent of organizations offer a Preferred Provider Organization (PPO) insurance plan, but High Deductible Health plans (HDHPs) linked with health savings accounts (HSAs) and health reimbursement arrangements (HRAs) continue their growth, the survey revealed, with more than half (59 percent) of organizations reporting at least one HDHP offering. Healthcare flexible spending accounts also remain popular, offered by 68 percent of employers this year. Interestingly, Telemedicine (or telehealth) is one of the fastest-growing health care benefits, increasing by 10 percent within the past year, growing from 23 percent in 2016 to 72 percent this year.

2. **Investment and Retirement Benefits.** Nearly all organizations offer some kind of retirement plan, with 93 percent offering traditional 401K plans, and 74 percent of employers matching employee 401K contributions at some level. Informal phased retirement programs are now offered by 15 percent
of respondents, up from 10 percent in 2015, while formal phased retirement programs fell to 6 percent, down from eight percent over the same period. One reason employers are thought to be more likely to offer informal programs is that “they prefer to limit phased retirement opportunities to high-performers and those with in-demand skills, and believe that an ad hoc approach makes that easier,” according to an SHRM article on the new report. But such informal approaches could pose legal issues regarding nondiscrimination based on who is offered the right to shift to part time, although this has not been tested in the courts, the article observes. As for educational assistance, more than half (56 percent) of employers offer tuition assistance for employees. Also, student loan repayment assistance is now offered by eight percent of employers, having doubled since 2018. (An obstacle is that the payments are considered taxable income for the recipients, and employers can’t claim a deduction for these payments.) And while matching employee charitable giving or donations for employee participation in charitable events has declined, paid time off for volunteering has increased by five percent, with 26 percent of organizations offering this.

3. **Family-Friendly and Wellness Benefits.** Most organizations (67 percent) have not made changes in these types of benefits in the past year. “Benefits in this space may represent an opportunity for employers as they are often among those that generate the most enthusiasm from employees, and many can be provided at low cost,” the report notes. The largest increase in any wellness benefit over the past five years has been the purchase of standing desks, with 60 percent of respondents saying they provide or subsidize the cost of switching from a sitting desk to a standing desk. Also, as organizations look to recruit and retain younger workers, benefits for new parents such as lactation or mothers’ rooms for breastfeeding are increasing, as are support services, such as lactation consulting and education.

4. **Leave and Flexible Working Benefits.** Nearly all organizations provide paid vacation (98 percent) and sick leave (95 percent) to some or all employees, but this is now most commonly provided through a common paid-time-off bank that combines both vacation and sick-leave time. Employers continue to offer generous paid leave for new parents, with about a third (34 percent) of organizations offering paid leave to mothers and slightly fewer (30 percent) to fathers. Open (unlimited) leave is uncommon and is only offered by 6 percent. “Telecommuting has become more widely offered among organizations of all sizes over the last five years, with ad hoc telecommuting (69 percent) showing the greatest increases, up 13 percent since 2015,” the report points out. More than a quarter (27 percent) of organizations offer fulltime telecommuting. Finally, flexible scheduling benefits of various kinds are available in many organizations, with more than half of organizations (57 percent) offering flextime during core business hours.

5. **Programs and Services Benefits.** Most employers (71 percent) report making few changes in this area. Food and beverage benefits are largely unchanged in the last five years. Most workplaces provide a break room or kitchenette and free coffee to employees, but only 13 percent offer subsidized or free cafeterias. Almost a third (31 percent) offer free snacks and beverages. Pets have been a focus of new benefits offerings in the last few years, with pets at work growing to 11 percent in 2019. Other pet-related benefits, like pet health insurance, are offered by 15 percent of organizations.
For a quick, informative listing of what SHRM sees as benefit programs which have been most frequently added or dropped by employers, be sure to check out their “Benefits: What's Hot and What's Not” list in the June 25 article entitled “Employers Boost Benefits to Win and Keep Top Talent” by Stephen Miller on the SHRM website.

- SHRM: “Employers Boost Benefits to Win and Keep Top Talent”
- SHRM 2019 Employee Benefits Survey: Executive Summary
- SHRM 2019 Employee Benefits Survey: Healthcare and Health Services
- SHRM 2019 Employee Benefits Survey: Investment and Retirement
- SHRM 2019 Employee Benefits Survey: Leave and Flexible Working
- SHRM: 2019 Employee Benefits Survey: Programs and Services

Arnold Ventures: An Update

Robb Gray, the Vice President of Policy & Advocacy for Arnold Ventures LLC, has recently updated NCTR on their plans to release a statement of principles for public pension engagement in the near future. It is intended to describe the context for their reasons for involvement in this area, what their beliefs are, and how they approach the issue.

Arnold Ventures is a holding company created at the end of 2018 that now manages the giving for the various entities created and controlled by billionaires John and Laura Arnold, including the Laura and John Arnold Foundation (LJAF), Action Now Initiative, and the Arnolds’ donor-advised fund.

One reason the Arnolds shifted to an LLC was because they were not creating change fast enough through grants to nonprofits and they believed they could make changes faster through an LLC, according to Arnold Foundation president Kelli Rhee. She told the Chronicle of Philanthropy that “[w]e have to be thinking about driving change at scale.” “We’ve come to the realization that we have always been and will always be about affecting policy change,” she explained.

Rhee also told the Chronicle of Philanthropy that Arnold Ventures “will continue to hold ourselves to the highest standards of openness and transparency” and becoming an LLC was not intended as a way to hide their spending. Indeed, Gray explained to NCTR that despite earlier concerns, the new Arnold Ventures website does indeed disclose grants online, accessible via a grants tab on the homepage, with a link to a searchable database.

Gray advised they are currently in the process of updating their website Grant Agreement Listing to now include grants from January 1, 2011 to March 31, 2019 with specific categorization. All 2019-future Donor-Advised Fund and LJAF “strategically relevant grants” will also be updated quarterly on the website, he told NCTR, and all 2019-future Action Now Initiative “strategically relevant grants” will be posted annually on the website at the end of a calendar year.

In order to search for grants related to public pensions on the Arnold Ventures’ website, select “retirement policy” as the “issue”. Also, be sure to note that the Arnold Ventures finance/compliance department lists all groups by their IRS designated names.

This is important to know, because, for example, when the new Equable Institute appeared at the end of 2018, its funding was not apparent, even though Gray explains that it was funded by a start-up grant from the LJAF of approximately $695,000.

“Equable” is the “doing business as” name for “Retirement Security Foundation,” the official IRS name. Thus, the Arnold Foundation support for Equable was not identified at the time.
Gray also advises that since September 2018, the Arnold Ventures Board and public finance team have been reviewing its public pension strategy. This evaluation has included talking with existing grantees and partners as well as a broader range of thought partners and stakeholders. “Through this engagement, we have experienced both areas of agreement and disagreement with groups on all sides of this issue,” he has acknowledged.

“At times, we found that the Foundation’s purpose and goals have been unclear or misunderstood and, as a result, we have potentially missed opportunities for greater collaboration with a wider set of groups,” he explained to NCTR. “Moving forward, it is our intention to be more clear about what guides our work in this space and to adopt a more inclusive approach to the work,” he said.

Gray explained to Maureen Westgard, NCTR’s Executive Director, the “key takeaway is that we want to step back from being prescriptive,” and that ultimately, “it’s about finding a balance between fiscal sustainability, retirement security, accountability, and approach.”

Arnold Ventures “believes this work is important and we take our engagement seriously, because the stakes couldn’t be higher for taxpayers, as well as the millions of public workers who depend on their retirement systems to deliver them a stable, adequate, and secure retirement,” Gray has assured NCTR.

Leigh Snell, Director of Federal Relations, National Council on Teacher Retirement
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**NASRA News Clips**

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The reimagined idea of a corporation drops the age-old notion that they function first and foremost to serve their shareholders and maximize profits. Investing in employees, delivering value to customers, dealing ethically with suppliers and supporting outside communities are now at the forefront of American business goals. [CNBC Council of Institutional Investors response](https://www.cnbc.com/2019/08/19/council-of-institutional-investors-reveals-2019-top-50-diversity-investors.html)

**Federal Focus**

| Study finds public pension funds are leading strong growth in ESG investing |

In a recent Revenue Ruling, the IRS concludes that a retirement plan distribution is taxable to the participant in the year it was distributed, regardless of whether the individual cashes the check, sends it

This paper studies whether U.S. public pension funds reach for yield by taking more investment risk in a low interest rate environment. ... We find that funds on average took more risk when risk-free rates and funding ratios were lower. ... Consistent with risk-shifting, we also find more risk-taking for funds affiliated with state or municipal sponsors with weaker public finances. We estimate that up to one-third of the funds' total risk was related to underfunding and low interest rates at the end of our sample period. [Abstract and full paper](https://onlinelibrary.wiley.com/doi/abs/10.1111/jpb2.12345)

Studies & Reports

Federal Reserve study finds public pensions take more investment risk when rates and funding levels are lower

**Studies & Reports**

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Study finds public pension funds are leading strong growth in ESG investing

Sustainable, responsible and impact investing assets reached $12 trillion in early 2018, according to the U.S. SIF Foundation's biennial Report on U.S. Sustainable, Responsible and Impact Investing Trends. That 38%
back, destroys it, or cashes it in a subsequent year. Furthermore, income tax withholding and Form 1099-R reporting is required. IRS notes that they continue to analyze other issues involving uncashed checks from eligible retirement plans including situations involving missing participants.

IRS Revenue Ruling 2019-19

Buck

CRS: Social Security Retirement Earnings Test

When considering repeal of the Social Security Retirement Earnings Test, research indicates it would have different impacts across the wage spectrum. The SSA’s Office of the Chief Actuary estimates that, over the long-range projection period, repeal would have a relatively small positive effect on the solvency of the SS Trust Funds, primarily due to the fact that it would increase early retirement reductions more than it would increase benefit entitlements.

Read the report

Tweet of the Week

In 1911, Massachusetts became the first state to offer a pension plan to general state employees. It took some time, however, for pensions to become available in most states, with just six offering any form of a civil service pension plan as of 1929.

Jump from 2016 represents a compound annual growth rate of 13.6% since the U.S. SIF Foundation started measuring U.S. assets in 1995. The lion's share - $8.6 trillion - is managed on behalf of U.S. institutional investors. Public pension funds and other publicly pooled portfolios accounted for 54% of the $8.6 trillion, Pensions & Investments (subscription)

See the study

ESG@NASRA.org

Perspectives

Rebuttal to NIRS paper: Only a DC plan can remove legislature's ability to short retirement benefit payments

But it is only a Defined Contribution program that can wholly remove from legislators the temptation to ask (OK, require) future generations to pay for this year's benefit accruals, sometimes leaving them with bills of such magnitude as to imperil provision of basic human services. Only a Defined Contribution ensures that the retirement benefit is always by definition 100% funded. And only in a Defined Contribution program is the benefit defined up front and transparent to all. And that, dear readers, is the purpose of pension reform.

Elizabeth Bauer in Forbes

See the NIRS paper

National Association of State Retirement Administrators
Does Diversification Still Work?

Can investors hedge investments using diversification in order to protect portfolios in a down market? When it comes to global markets, the chief investment officer (CIO) of the world’s largest pension fund says this may no longer be possible. But what do nine of the top U.S. public pension systems’ CIOs think? Join us in Nashville, October 12-15, to find out.

Hiro Mizuno, CIO of Japan’s $1.46 trillion Government Pension Investment Fund (GPIF), thinks global markets are too much in sync, according to coverage by Chief Investment Officer of his comments at a recent investment education workshop being held by the California Public Employees’ Retirement System (CalPERS) investment committee. Mizuno, also the executive managing director for the GPIF, provided CalPERS trustees with a presentation on GPIF’s experience aligning interests with investment managers on fees, time horizon and sustainability.

During the fourth quarter of 2018, GPIF reported a mark-to-market loss of $150 billion. “I’ve never seen in my whole career as an investment professional every single asset class we lost money,” Mizuno is quoted as saying. As he explained, the conventional wisdom of portfolio diversification is that “when we lose money in equity, we make profit in fixed income.” However, as he noted, “we lost in every single asset classes and we also lost in a currency translation as well. It never happened in the past.”

Why? Mizuno said every asset class went in the same direction because the global markets are too much in sync. They are so linked, he said, that “[w]hen we wake up and find the New York stock market has plunged, everybody expects that the Tokyo market will go down as well.”

“That’s what’s really concerning to me,” he said. “Whether the conventional wisdom of portfolio diversification will save us.”

Mizuno also told the CalPERS board this is one reason why so many investors are trying to increase their asset allocation to private assets and private investments—because they’re not correlated to the public market.

Mizuno also discussed the GPIF’s new performance-based fees, which were introduced in 2018 with the long-term goal of better aligning interests between the fund and its managers. GPIF’s annual report, released July 5, showed its payments to managers for the fiscal year ended March 31 dropped 40 percent, to $273 million, from a record high the year before, according to Douglas Appell, writing in Pensions & Investments last month.

As Appell explained, the payments amounted to two basis points of GPIF’s pension portfolio, a drop from three basis points the year before, and represented the lowest level since the fiscal year ended March 31, 2015, when the fund announced plans to more than double its portfolio’s equity allocation target to 50 percent and cut its Japanese government bond target to 35 percent from 60 percent.

The performance-based fee approach was introduced for all external managers in April 2018. Essentially, as the P&I article explains—and as Mizuno’s PPT presented
at the CalPERS meeting further details – if active managers do not exceed their benchmarks, they receive fees equivalent to what a passive strategy for their asset class would provide. If a manager beats their benchmarks, “fees increase in relation to the alpha they deliver, reaching the level GPIF paid under the prior fixed-fee system only if a manager achieves the target return agreed upon in discussions with GPIF,” Appell explains. And if managers exceed their alpha targets, GPIF will pay more than what it paid under the prior system.

Mizuno also discussed with the CalPERS board his views on ESG investing (using environmental, social and governance factors to measure the sustainability and ethical impact of an investment in a company or business) and the approach GPIF takes as a “universal owner and cross-generational investor.” GPIF invests $28 billion of its assets under management in ESG and signed the Principles of Responsible Investment in 2015.

In an interview with Bloomberg in May, Mizuno said asset managers are “key players in the investment chain and it is imperative that we share the same values.” He explained GPIF encourages ESG integration in line with investment styles, stating that “ESG needs to be integrated beyond the analysis into investment decisions.” Mizuno also told Bloomberg that he thought “the monster in the room” needs to be addressed, which he said is the fiduciary duty of asset managers. “The question of ESG and fiduciary duty also depends on the customer’s investment time horizon,” he explained, and said that failing to integrate ESG factors “is against the fiduciary duty, especially for clients who have long-term horizons.”

“The other question is whether making extra returns is the only way to satisfy one’s fiduciary duty,” Mizuno said. “Our view of integrating ESG is not about beating the market but about making the capital markets more sustainable,” he insisted, saying that ESG “can be a catalyst to promote the sustainability of markets.”

(GPIF’s investment portfolio returned 1.52 percent for the fiscal year 2018 ended March 31, with a total asset value of approximately $1.464 trillion, exceeding Norway’s Government Pension Fund Global by nearly $400 billion. For fiscal 2018, foreign equities was the top-performing asset class for GPIF, returning 8.12 percent, followed by foreign and domestic bonds, which returned 2.7 percent and 1.4 percent respectively. Its annual rate of return has been 3.03 percent since fiscal 2001, and the asset allocation for the fund as of the end of March was 26.3 percent in domestic bonds, 25.53 percent in foreign equities, 23.55 percent in domestic equities, 16.95 percent in foreign bonds, and 7.6 percent in short-term assets.)

What do some of the top public pension CIOs think of Mizuno’s concerns with global markets? And what are their thoughts regarding Japan’s new performance-based fee structure? These are likely to be among the questions that the panel of CIOs at NCTR’s Annual Conference will be asked when they participate in an unprecedented hour and one half, free-flowing question and answer session with conference attendees, moderated by NCTR’s Executive Director Maureen Westgard.

CIOs will include:

- Jerry Albright, CIO, Texas TRS
- Mike Brakebill, CIO, Tennessee CRS
- Laurie Martin, CIO, Connecticut TRB
- Amy McGarrity, CIO, Colorado PERA
- John Morrow, Deputy Executive Director, Investments and CIO, Ohio STRS
- Andrew Palmer, CIO, Maryland State Retirement and Pension System
- Mansco Perry, Executive Director, Minnesota Investment Board
- David Villa, Executive Director and CIO, State of WI Investment Board
- Ash Williams, CIO, Florida State Board of Administration (invited)

“Where else will you be able to hear from such a distinguished group of CIOs in one setting,” asked Westgard. “Talk about ‘one-stop shopping,’” she said.

This is one presentation you will not want to miss!
Mandatory Social Security and Teachers

Mandatory Social Security coverage of teachers is still on the radar of critics of public pensions, as a recent blog post demonstrates. With the chance for Social Security reform legislation advancing in the House of Representatives still a possibility, opponents of mandatory coverage should take note.

TeacherPensions.org, whose byline is “Fixing an unfair and insecure system,” is a project of Bellwether Education Partners, which is a 501(c)(3) non-profit and a strong supporter of school choice. It is funded, in part, by grants in the past from the Laura and John Arnold Foundation, which has given Bellwether a total of at least $1.9 million dollars since 2013 to “educate policymakers and the general public about issues affecting teacher pensions.”

TeacherPensions.org believes “[c]urrent teacher retirement systems are often designed in ways that systematically disadvantage young and mobile teachers and impair the ability of schools to recruit, hire, retain, and compensate high-quality teachers.”

One of the ways this is done by some states, according to Bellwether and TeacherPensions.org, is by “choosing” not to become part of Social Security, “betting they could provide better benefits through their state pension plans alone than through the combination of a pension and Social Security.” But Bellwether claims this “works well only for the small percentage of teachers who stay 30 or more years in a single retirement system.”

Bellwether senior associate partner and editor for TeacherPensions.org, Chad Aldeman, pointed out in a recent blog post that half of all new teachers will not stay long enough to qualify for a pension at all. For those who do qualify, many will receive pensions worth less than their own contributions. “For teachers in states without Social Security coverage, they’re at risk of leaving their public service with very little in the way of retirement savings,” he said.

Aldeman’s blog is essentially a rewrite of a report that he coauthored in 2014 entitled “Uncovered: Social Security, Retirement Uncertainty, and 1 Million Teachers.” This report pointed out, in addition to the two points referred to above, that:

- state pension plans in states without Social Security coverage are in worse financial shape than pension plans in other states, “leaving uncovered teachers vulnerable to future benefit cuts or increases in their employee contributions”;
- extending Social Security coverage to all teachers would “eliminate” the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP); and
expanding Social Security coverage to all state and local workers will “help eliminate the existing long-term funding shortfall” for the program. Aldeman notes, “States aren’t locked into keeping their teachers out of Social Security,” and that they should “reconsider their decades-old decisions.” “While not sufficient as a stand-alone benefit, Social Security could provide teachers with a floor of secure, inflation-protected, and portable benefits – something many teachers don’t have and genuinely need,” he concludes.

Although perhaps not a clarion call for mandatory Social Security imposed by the Federal government, it does appear at an interesting time in Congress, related to Social Security reform. Specifically, the House Ways and Means Committee has been holding hearings on legislation referred to as the “Social Security 2100 Act,” H.R. 860. Introduced by Congressman John Larson (D-CT), Chairman of the Ways and Means Social Security Subcommittee, the bill now has 210 cosponsors, all Democrats.

The Social Security 2100 Act would make a number of major changes to Social Security including increasing the Social Security tax rate gradually by .1 percent each year from its current 12.4 percent to 14.8 percent over the course of 25 years. Also, while Social Security taxes would continue not to be withheld from a person’s wages after that employee reaches a certain amount of earnings ($132,900 in 2019), the bill would reinstate the Social Security tax on anyone whose earnings rise above $400,000, so that earnings between $132,900 and $400,000 would not be subject to payroll taxes.

Social Security’s actuaries -- who predict the trust fund that holds revenues from Social Security taxes and pays benefits will run dry in 2035 -- estimate Larson’s bill would extend solvency into the next century. However, Republicans strongly object to the way in which this solvency is achieved. Congressman Kevin Brady (R-TX), the Ranking Republican on the Ways and Means Committee, charged millennials would get “ripped off” since they would not get back as much money as they put in over the years under the Larson formula.

“To give your grandma a mere $32 more a month in her Social Security, a lower-earning grandchild would pay over $53,000 in higher payroll taxes,” Brady said. “Middle-class young people will pay even more,” he warned.

While Larson says he wants to see the bill passed by the House when Congress returns from its summer break in September, strong GOP opposition virtually guarantees that it will go nowhere in the Senate. But then again, 2020 is an election year, and more Republican Senators are up for re-election than Democrats, so stranger things have happened.

The point being, if it is possible that major Social Security reform could be on the table, then it is possible that mandatory Social Security for public employees could become part of the mix. After all, including all newly hired public employees in Social Security would raise over $81 billion in additional revenue over 10 years, according to Congressional estimates, and could help pay for reforms. Also, some argue Social Security is a needed safety net in old age due to dire public pension underfunding, as Aldeman states.

While no effort to impose mandatory Social Security is currently pending in Congress, the appearance of the TeacherPensions.org blog post could be a signal that more is possible to come in this regard. NCTR will be sure to keep its members informed if any such efforts arise.

- TeacherPensions.org: “Why Aren’t All Teachers Covered By Social Security?”
- The CT Mirror, “House Republicans Slam Larson’s Plan to Reform Social Security”
Raiding Retirement Savings

More than half the respondents to a new survey acknowledge accessing their retirement savings for reasons other than retirement, with younger savers more likely to do so. Fewer employees feel their compensation is keeping up with their cost of living; can anything be done?

MagnifyMoney—a free, independent personal finance site providing news, calculators, resources and comparisons of financial products—recently surveyed 1,029 Americans and found approximately 52 percent of respondents admit to tapping their retirement savings account early for a purpose other than retiring.

Although the Investment Company Institute’s (ICI’s) larger database finds around one percent of retirement savings plan participants take withdrawals quarterly and around 15 percent take loans quarterly, the point is, no matter what the percentage, the two primary reasons are home ownership and personal debt, according to a recent article in PLANSPONSOR.

For example, the MagnifyMoney survey found 23 percent of those making an early withdrawal did so to help pay down non-medical debt, while 17 percent did so for a down payment on a home. These reasons are confirmed by an earlier 2016 Fidelity participant panel survey that found that among 743 respondents, 31 percent use loans for paying down/paying off high-interest credit card debt, 24 percent for home improvement or repairs, 21 percent to buy a home or refinance a mortgage and 19 percent to pay outstanding bills.

The survey also suggests younger savers are more likely to withdraw money from their retirement plans than older savers, with 54 percent of Millennial savers saying they’ve taken an early withdrawal from a retirement savings account, compared with 50 percent of Gen Xers and 43 percent of Baby Boomers.

Experts say this data shows the need for financial wellness programs, especially for Millennials and Gen Xers. These should cover all of the financial challenges an individual might be facing, not just retirement savings.

- PLANSPONSOR: “Debt, Homeownership Driving Participants to Withdraw Retirement Funds”
Is a Recession Really Imminent?

Increasingly, there is widespread talk of a slowdown or even a recession; but not all experts agree. While the White House worries “gloomy” news reports and a drumbeat of recession warnings could become a self-fulfilling prophecy—is it just politically motivated fear mongering, or is a serious market downturn ahead?

On September 3, the Wall Street Journal ran a story warning of a recession sign “to ignore at your peril” and pointing to a “grim omen” when the Institute for Supply Management’s manufacturing index fell to 49.1 in August from 51.2 in July, signaling a “likely contraction in manufacturing activity.” Yet that same day, the WSJ also ran another story that cautioned “recession signals flashed by the bond market may have been exaggerated.”

Also the same day, the New York Times ran a story about Trump Administration fears that America will “talk itself into a recession,” noting that some forecasters agree that “fear itself could become a problem.” Since consumers drive about 70 percent of economic activity in America, the story notes, “if they become spooked and pull back on purchases, growth could slow more sharply.”

And there are signs people are seriously concerned, if not exactly spooked. According to press reports, Google searches show recession fears have spiked since the end of July, when the Federal Reserve cut interest rates for the first time since the financial crisis.

So, what is going on? Is a recession looming, or is all of this just “fake news?”

Let’s discuss some of the reasons for concern. First, investment has slowed in 2019, as has manufacturing output. Global growth is also slowing, and the Federal Reserve has cut interest rates, driven to do so in part by concern over the trade war.

Then, on August 14, the yield on the two-year U.S. Treasury note moved above that of the 10-year Treasury note for the first time since 2007. A yield curve “inversion,” which has happened, to varying degrees, before every U.S. recession since the 1960s, is widely seen as reflecting fears of a slowdown in global economic growth.

The yield on the benchmark 10-year Treasury note has now fallen below the 2-year yield several times since.

As Giulio Martini, Partner and Director of Strategic Asset Allocation with Lord Abbett, recently explained, the yield curve between the 10-year and two-year notes is almost entirely determined by the markets’ expectations about future short-term rates. With the flattening, and subsequent inversion, of the Treasury curve between two years and 10 years, this “signals that investors now believe a more serious downturn is possible, extending the expected period of low interest rates further into the future,” Martini points out.

There are other general reasons for concern, as well. On September 2, CNBC.com did an article about other “recession signals that are flashing red.” These include:

- **Gross Domestic Product**: GDP in the U.S. appears to be slowing, with the economy expanding by just two percent in the second quarter of this year,
which is the lowest growth rate since the fourth quarter of 2018 and down from three percent growth in the first quarter.

- **Corporate profits**: Earnings growth estimates “have come down drastically” in 2019, according to CNBC, which noted analysts estimated S&P 500 earnings growth for the year would be around 7.6 percent last December, while the actual number is now closer to 2.3 percent.

- **Manufacturing contraction**: In addition to the drop in the Institute for Supply Management’s manufacturing index noted by the WSJ above, the U.S. manufacturing PMI (purchasing managers’ index) was 49.9 in August, down from 50.4 in July, reflecting a slowdown of U.S. manufacturer growth to its lowest level in almost 10 years.

- **Freight shipment slowdown**: The Cass Shipments Index fell 5.9 percent in July, following a 5.3 percent decline in June and a six percent drop in May, causing their report to “repeat our message from the last two months: the shipments index has gone from ‘warning of a potential slowdown’ to ‘signaling an economic contraction.’”

- **Copper prices**: Copper, a barometer of economic health because of its use in homebuilding and commercial construction, is down over 13 percent in the last half year.

- **Gold prices**: CNBC notes that gold is known as a safe haven in times of economic uncertainty, and gold prices have increased by more than 20 percent since May.

- **Business Spending**: In the second quarter of 2019, gross private domestic investment fell 5.5 percent, the worst since the fourth quarter of 2015, according to the Commerce Department.

On the other hand, consumer spending increased at an annualized rate of 4.7 percent this spring, its fastest quarterly increase in nearly five years. Unemployment continues to remain around its lowest level since 1969, the job market is growing faster than many economists predicted, and wage growth is picking up as companies compete for workers, the NYT notes.

So, what do the Wall Street experts say? Another CNBC.com article reported some reactions August 28, pointing out “not everybody’s sold on the idea of an imminent slowdown.”

For example, Brian Levitt, global market strategist for North America at Invesco, said this yield curve inversion might prove to be atypical, noting “just because the yield curve has inverted four to five basis points, doesn’t mean that this cycle has to necessarily end.” However, he said it does mean “we need greater clarity on policy.” He noted that as long as “uncertainty persists around trade and as long as business sentiment, business investment, new orders all slow, the 10-year’s going to go along with that.”

Levitt argued that what is needed is for the Fed to cut interest rates further and “we need clarity from the Administration” on trade. “It doesn’t mean we need a trade deal tomorrow, but we can’t keep going on with businesses not understanding the rules of the game, because if businesses don’t understand the rules of the game, it’s very hard to put investment into place,” he stressed. “And without investment in place, growth slows and yields go first.”

Lord Abbett’s Giulio Martini generally agrees, noting that the yield curve “can also invert and de-invert without a recession starting.” He says that while history shows that the yield curve has always inverted before a recession starts, the lag between the initial inversion and subsequent recession can be three years or longer. “Sometimes, investors can be wrong about the future of the economy and subsequent changes in short-term interest rates; there is no gravitational vortex that forces the economy into a recession once the yield curve has inverted,” he points out.
Martini also observes that although the shape of the curve has been reliably correlated with future economic outcomes, “it is not the cause of them.” Instead, he says Lord Abbett thinks a “broader causal mechanism, from tightening financial conditions to future economic activity,” can be found in the Chicago Fed National Financial Conditions Index (NFCI).

As he points out, the NFCI includes the slope of the yield curve along with a host of other direct indicators of credit spreads, funding conditions, liquidity, and expected volatility. He says in Lord Abbett’s view, “the NFCI currently shows that financial conditions are too accommodative to forecast an imminent U.S. economic downturn.” One thing that Martini and Invesco’s Levitt clearly agree on is the impact of the current trade war. As Martini observes, investors have “turned more pessimistic as worries about a global trade war and associated negative effects on business capital spending are reinforced by a bubbling cauldron of other risks: apparent economic weakness in China and Europe, increasing risks of a hard Brexit, and rising emerging market risk stemming from the consequences of political uncertainty in Argentina.” He also suggests that the record length of the current U.S. economic expansion “naturally lends itself to worries that a downturn is approaching.” With large government deficits and record low interest rates in most of the developed world, he also agrees there is also “little leeway for macroeconomic policy to counter the conditions that could lead to a global downturn.”

As the NYT sums it up, the President’s escalating trade war is the reason economists, traders and the American public are increasingly worried about the possibility of recession. “As the president punishes China with higher tariffs — and Beijing retaliates — the fight is exacerbating a global growth slowdown while dragging on investment and business confidence in America,” it stresses.

So, is a recession just around the corner? “I am really looking forward to hearing what our panel of CIO’s have to say about this in Nashville, as I am certain it will be one of the questions asked of them,” said Maureen Westgard, NCTR’s Executive Director. Westgard was referring to the upcoming NCTR Annual Conference, October 12-15, and an “Ask the CIOs!” panel of nine CIO’s from NCTR member systems that she will facilitate, designed to field audience questions. You will not want to miss it, so register now.

- *CNBC.com*: “Here’s a List of Recession Signals that are Flashing Red”
- *CNBC.com*: “Bonds Continue to Signal Oncoming Recession—5 Experts React to the Warning”
- *Lord Abbett*: “Another Turn in the U.S. Yield Curve Saga”

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### Creating Retirement Income in Defined Contribution Plans

How do defined contribution (DC) plans evolve from accumulating retirement savings to generating retirement income? With DC plans as the primary retirement vehicle for the private sector, and becoming an increasing factor in the public sector, answering this important question is key to any solution to the overall retirement income challenges confronting America today. This topic will be a focus of discussion at this year’s NCTR Annual Conference in Nashville, October 12-15, so be sure to register now, as you won’t want to miss it.
Most public sector employees still participate in the defined benefit (DB) model, which makes the issue of retirement income a relatively easy one since the DB plan specifies the benefit a participant will receive in retirement – a strong selling point for this approach that is often overlooked by its critics or downplayed as too antiquated and expensive for today’s world.

However, as we know, DB plans are becoming far less common in the private sector, with more than half of all global retirement assets now held in DC plans such as 401(k) accounts, Angela Antonelli, executive director of the Center for Retirement Initiatives (CRI) at Georgetown University’s McCourt School of Public Policy, said recently in Forbes. And, between now and 2030, 10,000 baby boomers will retire every day – many of whom will be doing so without a DB plan.

Furthermore, as DC components become increasingly used in the public sector approach to overall retirement security, these plans’ ability to provide for a significant source of income is also becoming important to government workers and employers. However, until recently, DC plan design innovations have been about accumulating savings, and not whether these assets set aside for retirement will generate and protect adequate income in retirement. The focus has been on making it easier to start saving for retirement and keep it up; auto-enrolling participants into plans and auto-escalating their contributions are some examples. How to invest retirement savings has also been made easier using target date funds, for example.

However, there has been less innovation in how to help participants once they retire. Antonelli stresses individuals “must know the options available and understand that decisions regarding how they choose to invest their savings — along with economic factors such as interest rates and inflation — can affect their monthly income in retirement and how long their assets will last.”

As she explains, the Georgetown University CRI recently partnered with Willis Towers Watson to examine potential solutions to generate retirement income in DC plans, describing how some of the available types of lifetime income options “balance priorities differently and can be used, alone or in combination, to meet individual retiree needs,” Antonelli points out.

The CRI-Willis Towers Watson study, entitled “Generating and Protecting Retirement Income in Defined Contribution Plans,” was released this past June. It stresses plan sponsors should not “make the perfect be the enemy of the good” and conclude that there is one “perfect solution” when there is a range of reasonable solutions and strategies they can choose from for participants and beneficiaries. “Factors such as plan design, participant demographics and behaviors, views on asset retention, portability, and regulatory flexibility will determine how, when, and what type of solutions will evolve and what individual sponsors will embrace,” the study underscores.

As Antonelli explains in her Forbes article, the study results show how some of the available types of lifetime income options balance priorities differently and can be used, alone or in combination, to meet individual retiree needs. She names and discusses six, as follows:

1. Immediate Annuity
2. Laddered Bonds
3. Target Date Fund (TDF) with Systematic Spending
4. Managed Payout Fund
5. TDF with Deferred Annuity
6. Guaranteed Minimum Withdrawal Benefit (GMWB)

The study models these different solutions using forward-looking economic and capital market scenarios in order to test the likelihood that each solution meets its primary objective, along with any additional qualitative considerations.
“It is time to move away from a myopic focus on wealth accumulation to emphasize generating and protecting lifetime income” with regard to DC plans, the study concludes, adding that “DC plan sponsors should be able to adopt lifetime income solutions and decumulation strategies that work well for employees without undue risk of litigation.”

In order to provide its members with a solid understanding of these study results, NCTR’s Annual Conference panel will feature Ms. Antonelli. She will be joined by Wendy Carter, Vice President and National Public Sector Defined Contribution Practice Director for Segal, and Sue Walton, Senior Retirement Strategist with the Capital Group, who will, respectively, discuss the lay of the land with regard to retirement income challenges facing public sector DC plans, as well as the various products that are available in the market place to address them in light of the CRI-Willis Towers Watson study.

Moderating the panel will be Jamie Wayman, Director of the Tennessee Consolidated Retirement System, which offers a hybrid plan. He will help explain the practical challenges that a public sector system’s DC component faces in dealing with these retirement income challenges.

“These decumulation issues are just one of the reasons why NCTR continues to strongly support the public sector defined benefit model,” said Maureen Westgard, NCTR’s Executive Director. “However, the reality is that more and more of our systems and their participants are now involved, to one extent or another, in defined contribution components that are serving as integral parts of the overall retirement security provided to public employees,” she continued.

“This panel underscores that there is much more to an effective DC plan than the administrative challenges of getting it set up and ensuring all the components necessary to make it an effective, efficient, and adequate savings vehicle,” Westgard noted. “It must also ultimately provide a source of income that can last through retirement,” she continued. “That is why I think this is such an important panel for the world in which we find ourselves today,” she concluded.

- Forbes: “6 Ways To Generate Lifetime Income In Retirement”

**Student Loan Debt and Retirement**

Student loan debt is not just an issue for college graduates, and it is having a demonstrable impact on the retirement security of both young and old alike. Student loan repayment benefits have been around for several years, but the idea of a student loan 401(k) match is relatively new. What is the latest on that front, both at the regulatory, as well as the legislative level, in Washington, D.C.?

Americans owed approximately $1.5 trillion in student loans at the end of March 2019, more than twice what they owed ten years earlier. The average student loan debt amount is approximately $37,000, but women and people of color bear the burden more than their white, male peers, according to Caitlin Zaloom, an anthropologist and associate professor at New York University and the author of a new book, “Indebted: How Families Make College Work at Any Cost.”
“They graduate with more debt. Takes them longer to pay it off. They're more likely to go into default. All of the downsides of debt are visited on the people who can bear it the least,” she told National Public Radio’s Elissa Nadworny in a recent interview. This debt is also having an impact on retirement security. A large majority of American adults (84 percent) say student loans are negatively impacting the amount they are able to save for retirement, according to new research sponsored by TIAA, conducted by the MIT AgeLab, and released at the end of July. Almost three out of four borrowers (73 percent) report they are putting off maximizing their retirement savings, telling researchers they expect to begin or increase their contributions once their student loans are paid off. Among those who are not saving for retirement at all, more than one quarter (26 percent) say paying off student loan debt is the reason why.

Significantly, the research finds parents and grandparents borrowing for loved ones are the hardest hit, with 43 percent who took out loans for children and grandchildren, saying they will increase retirement savings only when the student loan is paid off.

For several years now, an increasing number of employers have therefore been offering student loan repayment assistance as an employment benefit. Furthermore, according to Employee Benefit News, data showing the number of companies offering this perk “has nearly doubled” over the past year.

Larry Restieri, the CEO of Ayco, a Goldman Sachs company, agrees, saying in an interview that when it comes to employee benefit trends, student loan benefits is “the big one” that most are trying to get right, even more so that preparing for retirement, which is number two. He also noted it is “not just a recent graduate issue but it’s one that affects baby boomers greatly.” As he explained, “that’s not because they incurred the debt themselves. It’s because of their kids, and they’re taking on the debt.” This fits with the recent TIAA/MIT research results, noted above.

More recently, there has been increasing interest in an August 2018 Internal Revenue Service (IRS) private letter ruling (PLR) that allowed Abbott Laboratories to make 401(k) matching contributions while employees repay their student loans. Employees who voluntarily agreed to put at least two percent of pay toward a student loan would be eligible to receive an employer contribution equal to five percent of pay to their 401(k) plan.

However, according to a July article in Workforce, it appears “doubtful that Federal guidance allowing others to implement the idea will be issued any time soon.” It reported that since the PLR, the IRS has met with trade groups to talk about such possible guidance, according to David Levine, a principal at Groom Law Group. Levine told the Plan Sponsor Council of America’s national conference in April that “[t]he outcome of the meeting was not as optimistic as one might hope for.”

Why? Jeffrey Holdvogt, a partner with the law firm of McDermott Will & Emery, said he suspected that other plan sponsors have been asking for similar private letter rulings, but the IRS has turned them down. He and Levine agreed the IRS is probably concerned with “unintended consequences” if it were to broaden the scope of the initial private letter ruling or offer separate rulings to other plan sponsors. If expanded, it could set a precedent for other repayment programs.

According to the article, the attorneys think the general issue of needing to pay off a large liability while saving for retirement fits the same scenario as the student debt question. So where do you draw the line?

There is also the matter of pending legislation in this area that could be serving as a deterrent to IRS regulatory action, it was noted. Specifically, Levine and Holdvogt pointed to the Retirement Security & Savings Act, S. 1431, proposed by Senators Rob Portman (R-OH) and Ben Cardin (D-MD). Their legislation would permit employers to make matching contributions with respect to student loan repayments.
In addition, the Retirement Parity for Student Loans Act, S. 1428, sponsored by Senator Ron Wyden (D-OR), the Ranking Member of the Senate Finance Committee, would permit 401(k), 403(b), SIMPLE and governmental 457(b) retirement plans to make matching contributions to workers as if their student loan payments were salary reduction contributions.

This would be a voluntary decision on the part of plan sponsors. If a plan chose to offer this option, however, the rate of matching for student loans and for salary reduction contributions must be the same, and the benefit must be made available to all workers eligible to make salary reduction contributions and receive matching contributions on those salary reduction contributions. The benefit would apply only to repayments of student loan debt that was incurred by a worker for higher education expenses, and employees would be required to provide evidence of their student loan debt payments.

It is unclear whether these bills will receive consideration any time soon in the current Congress. It is also well to note that the one retirement bill that has cleared the House of Representatives earlier this year – H.R. 1994, the “Setting Every Community Up for Retirement Enhancement Act of 2019,” or the SECURE Act – does not contain any similar provisions dealing with such a matching program related to student loans. Therefore, for the time being, Levine said plan sponsors interested in adopting similar strategies in their 401(k) plans should rely on the guidance exactly as it was outlined in the original PLR. Companies that simply follow the “spirit” of the private letter may wind up having issues with the IRS, he warned.

- Forbes: “Student Loan Debt Statistics In 2019: A $1.5 Trillion Crisis”
- NPR: “Families, Not Just Students, Feel The Weight Of The Student Loan Crisis”
- TIAA/MIT: “TIAA-MIT AgeLab Study Finds Student Loan Debt Significantly Impacts Retirement Savings, Longevity Planning and Family Relationships”
- Employee Benefit News: “Student Loans are the ‘Big’ Benefit Trend, Goldman Sachs Ayco CEO Says”
- Workforce: “Student-Loan Matching Hits Snags”
- Groom Law Group: “IRS Private Ruling on Student Loan Benefit Under 401(k) Plan Likely to Fuel Interest”
Snapshot of This Week's FYI

1. The integration of environmental, social and governance (ESG) factors into investment processes and decision-making is growing rapidly. Some argue fiduciaries have an obligation to integrate ESG if they are to fulfill their fiduciary duties, but others insist ESG investing often violates the fiduciary responsibility of public pension trustees.
2. If older Americans can obtain health insurance from a source other than an employer, they are often more likely to retire sooner rather than later. But that can have an adverse impact on the retirement security of some of them.
3. What appears to be the largest cybertheft involving a public pension system has been reported several days ago in Oklahoma.

ESG Investing and Fiduciary Duty

The integration of environmental, social and governance (ESG) factors into investment processes and decision-making is growing rapidly. Some argue fiduciaries have an obligation to integrate ESG if they are to fulfill their fiduciary duties, but others insist ESG investing often violates the fiduciary responsibility of public pension trustees.

This will be just one of the areas touched on in NCTR’s upcoming back-to-basics webinar on fiduciary duty, September 26 at 3:00 PM/EDT. Watch for registration information coming soon.

ESG factors include a wide range of issues, in addition to traditional financial measures, that are to be used when analyzing investments. The approach grew out of the Socially Responsible Investment (SRI) movement that has been around for decades. However, ESG investing is different from ethical investing or values-based investing, as ESG investors actively choose companies because of their positive ESG attributes, as opposed to excluding certain industries or companies because of their ESG liabilities.

BACKGROUND

ESG investing dates back to 2004 and a joint initiative of the UN Global Compact and the International Finance Corporation (IFC). A year later this initiative produced a report entitled “Who Cares Wins,” which argued embedding environmental, social and governance factors in capital markets makes good business sense and leads to more sustainable markets and better societal outcomes. At the same time the so-called “Freshfield Report” was also released showing ESG issues are relevant for financial valuation.

In turn, these two reports triggered the creation of the Principles for Responsible Investment (PRI) at the New York Stock Exchange in 2006 and the Sustainable Stock Exchange Initiative (SSEI) in 2007. Today, the UN-backed PRI has more than 1,600 members representing over $70 trillion in assets under management with the goal of advancing the integration of ESG into analysis and decision-making, while the SSEI now has many exchanges requiring ESG disclosure for listed companies or providing guidance on how to report on ESG issues.

Since 2013, the idea that investors who integrate corporate ESG risks can improve returns has been growing rapidly, following the first studies that found good corporate sustainability performance to be linked to good financial results. For example, sustainable, responsible and impact investing assets reached $12 trillion in early 2018, according to the Forum for Sustainable and Responsible Investment Foundation (U.S. SIF). That represents a 38 percent jump from 2016, with $8.6 trillion
of this attributable to U.S. institutional investors. Public pension funds and other publicly pooled portfolios accounted for 54 percent of that total.

A 2018 responsible investing survey conducted by RBC and BlueBay Asset Management LLP in partnership with *Pensions & Investments* found that 90 percent of institutional investors believe ESG-integrated portfolios are likely to perform as well or better than non-ESG-integrated portfolios. The percentage of respondents seeing it as helping to generate alpha increased to 38 percent from 24 percent the year before.

In short, as Hazel Bradford, reporter with *Pensions & Investments*, put it in a recent article on what she described as ESG’s “spectacular boom,” asset managers and their investors “are getting more comfortable with the idea that integrating ESG considerations into investment decisions does not mean sacrificing returns and is an important part of risk management.”

However, not everyone thinks ESG is a good idea. Wayne Winegarden, Senior Fellow in Business and Economics at the Pacific Research Institute, a San Francisco free-market think tank, wrote an article in *Forbes* this past February in which he claimed, given “lower investment returns associated with ESG investing” as well as “the divergent values across the large number of people that public pension funds represent,” public plans clearly “harm public sector employees and retirees when they engage in ESG investing.” As support, he pointed to a 2008 study in the *Journal of Portfolio Management* that found “the cost of socially responsible investing is substantial,” as well as a more recent report by the Center for Retirement Research (CRR) at Boston College, which found socially responsible funds significantly under-performed their benchmarks. The 2016 CRR brief concluded “lower returns and fiduciary concerns make public pension funds unsuited for advancing ESG goals.”

Winegarden also compared the returns of ESG funds to the overall market. “The 8 ESG funds that have existed for 10-years have all under-performed relative to the S&P 500 over the long-term, most of them by a wide margin,” he found.

So, feelings can run high on either side of the debate. Also, asset owners and advisers often point to fiduciary duty as the underlying reason, regardless of which side they come down on.

Those who think they cannot integrate ESG issues into their investment processes or engage with companies on these issues believe ESG requires a trade-off in investment performance and lower risk-adjusted returns, thus violating a board’s fiduciary duty of loyalty by harming the value of investment assets. But others argue fiduciaries have a positive duty to consider ESG issues in their investment practices, and a failure to do so could be seen as a breach of their fiduciary duty of prudence.

So, what’s a board to do? Let’s examine the issue of fiduciary duty and whether ESG investing by pension trustees is mandated under fiduciary principles.

**YES, ESG INVESTING IS MANDATED UNDER FIDUCIARY PRINCIPLES**

Essentially, the argument in favor of ESG being required as a fiduciary duty goes like this:

- ESG factors are related to a firm’s long-term financial performance;
- the duty of prudence requires a trustee to consider material information; and
- therefore, trustees have an obligation to integrate ESG factors in their decision-making if they are to fulfill their fiduciary duties.

In short, ESG incorporation is seen as an essential tool to identify and address investment risks and opportunities. ESG supporters such as PRI believe that fiduciary duty requires trustees to be able to show that they have identified the relevant risks to their investments, including those related to ESG issues such as proxy access, corporate political activity and climate change; that they have put appropriate strategies in place to manage these risks; and that they have overseen and monitored
the actions of those charged with managing these risks, such as investment managers and companies. Those who use ESG factors agree. The 2018 RBC/BlueBay/P&I responsible investing survey (noted above) found more than half of respondents who incorporate ESG factors into their investment said it was because they consider it part of their fiduciary duty. This was twice as many as the previous year's number. The survey also found equities are no longer the primary focus of ESG considerations, with 60 percent of respondents incorporating the factors into their fixed-income portfolios, 43 percent into real estate, 36 percent into infrastructure and 34 percent in alternative assets.

**NO, ESG INVESTING IS NOT MANDATED UNDER FIDUCIARY PRINCIPLES**

At its heart, opposition to ESG is based on the belief investors can only pursue arbitrary, non-financial investment restrictions if it can be clearly demonstrated these activities do not harm the value of investment assets and lower investors' risk-adjusted returns. Otherwise, ESG investing is seen as violating the fiduciary duty of loyalty, which requires a trustee consider only the interests of the beneficiary. Accordingly, a trustee’s use of ESG factors, if motivated by the trustee’s own sense of ethics or to obtain collateral benefits for third parties, violates this duty of loyalty.

A recent academic examination of the issue by Max Schanzenbach, of the Northwestern Pritzker School of Law, and Robert Sitkoff, at Harvard Law School, expected to be published in the Stanford Law Review in 2020, argues that the reasoning to support ESG as a fiduciary duty is riddled with errors, as follows:

- the conflation of an ESG factor’s relationship to company performance with an investment profit opportunity;
- the assumption that ESG factors will always be underpriced and therefore associated with higher returns; and
- the belief that ESG factors can better assess long-term risk.

On the contrary, they argue a prudent trustee could just as easily conclude that an ESG factor could not cost-effectively be exploited for profit. Also, as with any other investment factor, an ESG factor “can work in both directions” and hence also be overvalued, so a trustee could also reasonably employ an “anti-ESG” strategy if they concluded that companies with low ESG scores were undervalued.

Finally, as far as ESG factors being better at assessing long-term risk, the professors point out this argument “rests on the unstated assumptions that financial markets have both mispriced ESG factors and, further, will not adjust for mispricing ESG factors over time.” They question these assumptions.

“All told, mandating a long-term ESG perspective for trustees or other investment fiduciaries is manifestly contrary to both law and economics,” their examination warns. They conclude ESG investing is permissible under trust fiduciary law only if (1) the trustee reasonably concludes that ESG investing will benefit the beneficiary directly by improving risk-adjusted return, and (2) the trustee’s exclusive motive for ESG investing is to obtain this direct benefit.

“In light of the current theory and evidence on ESG investing, we accept that these conditions could be satisfied under the right circumstances, but we reject the claim that the duty of prudence either does or should require trustees to use ESG factors,” they stress.

**CONCLUSIONS?**

So, who is right? Can trustees be expected to make ESG decisions that accurately reflect the values of such a diverse group of people as their plan participants and beneficiaries? Is Securities and Exchange Commission (SEC) member Hester Peirce (R) correct in recently saying “When a pension fund manager is making the decision to pursue her moral goals at the risk of financial return, the manager is putting other people’s retirements at risk”?
Or is PRI correct when it says for investors, “ESG data is increasingly important to identify those companies that are well positioned for the future and to avoid those which are likely to underperform or fail.” Is ESG investing “a proxy” for how markets and societies are evolving and how the ideas of valuation are adapting to these changes?

The Institute for Pension Fund Integrity (IPFI) believes it is important to investigate the merits and potential scope of ESG investments, and they should be made when they add value to a fund. But “[w]hen such investments will not improve the financial performance of the fund, or the decision to invest in them is based on political motives, they should be forgone,” it says in its September 2018 report, “ESG Investing for Public Pensions: Does It Add Financial Value?”

“While ESG investing can have benefits when considered as a part of a robust investment strategy, ultimately, if the investment does not add alpha then the fiduciary should opt for something else,” the IPFI report concludes.

In any case, ESG investing is certainly a hot and controversial topic. What do you think?

- *Pensions & Investments*: “Public Funds Taking the Lead in Spectacular Boom of ESG”
- *Forbes*: “The Remarkable Rise Of ESG Investing”
- *Forbes*: “Public Pension Funds’ Sole Responsibility is to Secure the Retirement of Public Sector Workers”
- *IPE*: “US Academics Challenge Whether ESG Investing Must be Fiduciary Duty”
- *PlanAdviser*: “Plan Sponsors Must Remember Fiduciary Duties When Selecting ESG Investments”
- *IPE*: “SEC Highlights Proxy Voting Rules, Guidance Amid ESG Debate”

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**The ACA and Early Retirement**

If older Americans can obtain health insurance from a source other than an employer, they are often more likely to retire sooner rather than later. But that can have an adverse impact on the retirement security of some of them. Did the Affordable Care Act (ACA) inadvertently exacerbate this problem?

The ACA could also present other unanticipated impacts on retirement in places you least expect, such as possible adverse effects when a retired teacher returns to work and is placed on the healthcare plan for active employees covered by the ACA. If you are not familiar with this and other serious problems that can arise providing health benefits to reemployed retired teachers, you will not want to miss this important session at NCTR’s upcoming annual conference in Nashville.

According to the preponderance of research to date, the availability of insurance that is not contingent upon one’s own continued work – such as from Medicare, or from being a dependent on a spouse’s policy, or from coverage intended for early retirees, or from COBRA – significantly increases the probability of individual’s retirement. This can not only affect the nation’s work force, reducing the labor supply of older Americans, but it can also have an impact on retirement security, as the Center for Retirement Research (CRR) at Boston College points out in a recent post on its *Squared Away* blog concerning a recent study by the University of Michigan Retirement and Disability Research Center on the ACA and its impact on early retirement and seniors.

Specifically, many baby boomers are poorly prepared financially to retire. They “should be working longer – not retiring sooner – to improve their retirement outlook,” the post warns.
Research data supports this grim outlook for baby boomers. Born between 1946 and 1964, they are retiring at the rate of approximately 10,000 a day and will do so for the next decade. But research by the Insured Retirement Institute (IRI) finds 45 percent of them have no retirement savings, and of that slight majority who do, 28 percent have less than $100,000.

This means approximately half of retirees are, or will be, living off of their Social Security benefits. But changes to Social Security implemented in 1983 are gradually raising the full retirement age to 67. Accordingly, workers turning 62 in 2019 face increasing reductions in Social Security benefits if they start receiving benefits before their normal retirement age. For example, starting benefits now at age 62 results in receiving only 72.5 percent of the full benefit that would be payable at age 66 and a half.

Thus, once fully phased in for Americans born in 1960 and later, the reduction in Social Security benefits for those choosing to retire and draw benefits at age 62 will equal 30 percent less than the benefits at the full retirement age of 67.

So, for many baby boomers, working longer and not retiring early is important. Also, as far as effects on the work force are concerned, companies are now saying they are more concerned than they used to be about the challenge of replacing the knowledge and skills those older workers will take with when they retire, as opposed to their working longer than expected and blocking opportunities for mid-level management to advance.

Therefore, when the ACA created subsidized alternatives to employer-sponsored health insurance coverage beginning in 2014, it was widely feared this would reduce labor supply, particularly among older workers who may have been more likely to work less in response to new health insurance options. This was expected both because, as the authors of the recent study for the University of Michigan Retirement and Disability Research Center suggest, these employees were “at an age when attachment to the labor force begins to weaken,” as well as because the ACA prohibited charging premiums based on health status, which may have disproportionately benefited older individuals.

However, this new study, performed pursuant to a grant from the U.S. Social Security Administration funded as part of the Retirement Research Consortium, fails to find any reductions in labor supply in response to the ACA. While it found that insurance coverage of Americans ages 50 through 64 did indeed increase significantly after the ACA, with the uninsured rate dropping from 16 percent in 2013 to 12 percent in 2014 and 10 percent in 2015 and 2016, there was “no changes in labor supply of older Americans either in response to subsidized marketplace coverage” or in response to the expansion of Medicaid eligibility in some states.

Furthermore, it also failed to find labor supply effects even for subgroups with less than a high school education or those with fair or poor health, who might have been expected to have a greater labor supply response. On the contrary, the results actually imply that “Medicaid expansion increased labor force participation and work for older individuals who were in fair or poor health.”

In summary, the results suggest that for Americans approaching retirement, the ACA achieved its primary goal of increasing coverage without the unintended consequence of reducing labor supply – or inadvertently the willingness of some baby boomers to remain working in order to improve their retirement income outlook, as CRR also notes.

The impact of the ACA is still being felt and can appear in the least expected places. For example, one area that receives little attention is that associated with healthcare for retired teachers who return to work, and the risks that can be posed to both active and retiree health plans as well as to the healthcare coverage of the returning teacher.
Do you have a clear understanding of the rules governing healthcare plan participation that must be navigated when a retired teacher returns to work? The issues of liability that can arise when they are not? And how do you deal with the responsibilities for insuring communications regarding healthcare coverage are clear and handled appropriately before retired teachers are rehired?

For answers to these and other important questions, be sure to attend the panel, “Providing Health Benefits to Reemployed Retired Teachers,” at NCTR’s 97th Annual Conference in Nashville, October 12-15. Register now!

- University of Michigan Retirement and Disability Research Center: “Is the Affordable Care Act Affecting Retirement Yet?”

$4.2 Million Public Pension Cyberattack

What appears to be the largest cybertheft involving a public pension system has been reported several days ago in Oklahoma. The hack underscores the importance of knowing if your retirement system’s cybersecurity efforts are adequate, and how to determine if they are, which will be the focus of a session on “Cyber Audits” at NCTR’s annual conference in Nashville.

The Oklahoma Law Enforcement Retirement System (OLERS) website currently carries an “Important Announcement” advising OLERS “was recently a victim of a cyber-crime where $4.2M was illegally stolen.” The system says they have notified the FBI “who is conducting an active investigation of the crime,” but that due to its ongoing nature, “we cannot comment further on the details.” However, the OLERS website assures the system is “certain the stolen funds will be recovered,” and that “no pension benefits to members or beneficiaries have been impacted or put at risk.” It promises all benefits “will continue to be paid in a timely fashion as always.” OLERS administers retirement/survivor retirement and medical benefits for members of the law enforcement profession of the state of Oklahoma.

According to press reports, Duane Michael, Executive Director of OLERS, said the theft happened on August 26, after an employee’s email account was hacked. He said the funds were being managed by an outside investment manager, and that about $477,000 has been recovered.

State and local governments continue to be the targets of cyber criminals, with public-sector attacks increasing faster than those in the private sector. In June, the City Council of Riviera Beach, Florida—a suburb of Palm Beach—voted to pay approximately $600,000 in ransom to hackers who took over its computer system when a police department employee opened an infected email attachment. Other hacks of public pension systems involving the use of stolen identities to register for account access to divert payments have involved hundreds of thousands of dollars.

How do public pension systems know if they are adequately prepared to address the cyber threats that confront them? That is the major question that the “Cyber Audits” panel discussion on the first day of NCTR’s 97th Annual Conference in Nashville, October 12-15 will address.

This session will provide a clear understanding of how to conduct a cyber audit—including which areas should be covered and what questions should be asked; how
to work within applicable legal frameworks in doing so; and how to decide whether you use a third party to conduct the audit.

“We are going to focus on the nuts and bolts of what you need to do in order to learn if your cybersecurity efforts are enough,” said Maureen Westgard, NCTR’s Executive Director. “I think we all know what we have to do and how we have to do it,” she continued. “I want us to know how we find out if we, in fact, are actually doing it, and doing it right,” she concluded.

- Fifth Domain: “Oklahoma Pension Fund Reports $4.2 Million Cyber Theft”

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NASRA News Clips

September 11, 2019

In the Media

Alan Greenspan: "It's only a matter of time" before negative interest rates are in the US

"You're seeing it pretty much throughout the world. It's only a matter of time before it's more in the United States," Greenspan told CNBC's "Squawk on the Street" on Wednesday, adding investors should watch the 30-year Treasury yield. The 30-year U.S. rate traded at 2.21% Tuesday. It reached an all-time low the week of August 26. CNBC

Oregon PERS opens employer incentive fund to provide matching funds on extra pension contributions

Oregon's public pension fund has opened the door to its employer incentive fund, inviting its most deficit-challenged members to apply for matching funds from the state if they can come up with some extra dough to pay down their unfunded liability. OregonLive About the employer incentive fund

Studies & Reports

NASRA publishes update to employee contributions issue brief

Although investment earnings and employer contributions account for a larger portion of total public pension fund revenues, by providing a consistent and predictable stream of revenue to public pension funds, contributions from employees fill a vital role in financing pension benefits. This issue brief examines employee contribution plan designs, policies and recent trends.

Issue Briefs, Papers & Analysis@NASRA.org

S&P Global: Credit Effects of Municipal Pension Plans Approaching Asset Depletion

To illustrate what happens at asset depletion, we have provided select examples from around the U.S. of severely funded pension plans, which we define here as under 40% funded. The S&P Global Ratings criteria for rating U.S. state debt incorporates a one-notch rating override for an aggregated pension ratio expected to fall below a 40% threshold and additional overrides as this ratio falls to reflect the extremely weak funding levels. Read the analysis Credit Effects@NASRA.org

State and local governments added 6,000 jobs in August, and revisions to prior months add 40k+ more
local government budgets. As a result, local government workforces in many places are shrinking. ... Many Americans take for granted that their local governments will provide public services like police protection, fire protection, street sweeping and refuse collection. But it may well become harder for local governments to carry out those basic functions - because of rising pension costs." Read the article

The U.S. Bureau of Labor Statistics reported that state and local governments added an estimated 6,000 jobs in August 2019, with all of the gains accruing to state governments. Revisions to prior months' data added 48,000 state government jobs and eliminated 10,000 local government jobs from the running total. The current level of combined state and local government employment is the highest since June 2009.

Employment@NASRA.org

Federal Focus

GAO report on retirement security: income and wealth disparities continue through old age

In a report to U.S. Senate Budget Committee Ranking Member Bernie Sanders (I-VT), GAO found, among other things, that average income and wealth was generally higher over time, disproportionately so for the top quintile. For quintiles with lower wealth, future income from defined benefit pensions and Social Security provide a relatively significant portion of resources in retirement for those who expect such income. Read the report

NASRA News Clips

September 18, 2019

Federal Focus

Study finds past pay-to-play in public pensions has been effectively curbed by SEC rule

According to researchers at the University of San Diego and University of Arizona, the presence of governmental clients for an investment advisory firm is strongly associated with past owner and officer contributions to state government officials. However, the prevalence of pay-to-play activities has declined after the SEC adopted an antifraud rule making it illegal for investment advisors to receive business from government entities within two years after making a related political contribution. Institutional Investor Read the paper

Moody's publishes annual report on state pension and OPEB liabilities

Adjusted net pension liabilities (ANPL) declined in states' fiscal 2018 reporting due to healthy investment returns in fiscal 2017. States typically report their pension funding positions with a one-year lag. Favorable investment returns again in 2018 will lead to another modest decline in fiscal 2019 reporting of pension liabilities. Fiscal 2018 was the first year states reported other post-employment benefit (OPEB) liabilities under new accounting rules, which allow improved comparisons between pension and OPEB liabilities. Adjusted net OPEB liabilities range widely for the 50 states. See the report

S&P Global releases analysis of state OPEB risks

To better understand what risks might lie ahead for OPEBs, we believe it is essential to gain insight to the
federal government. In the filing, the DOJ notes that "the United States has a heightened interest in finding the Secure Choice Act preempted because the Act is among the first of a number of similar state auto-individual retirement account (IRA) laws to be challenged." It is expected that the court will accord the federal government deference on this issue, and allow the legal challenge to CalSavers to continue to trial.

Tweet of the Week

Unlike in the private sector, nearly all employees of state and local government are required to share in the cost of their retirement benefit. Employee contributions typically are set as a percentage of salary by statute or by the retirement board.

Op-Ed: Why everyone should care about this report on Social Security

A report recently released by the Social Security Administration contains a comprehensive menu of actions that Congress can take to fix the program's long-term solvency. You can learn what various measures cost or save and be able to read brief and understandable explanations of each of them. The options come with color charts that show graphically how each change would affect Social Security's finances, and you'll be able to see which member of Congress or organization proposed them.

SLGE publishes infographic highlighting challenge in attracting and retaining K-12 education professionals

"The research makes clear there is a growing need for education professionals, yet state and local governments already are having a tough time attracting and retaining teachers. This baseline data will help to better understand the efficacy of targeted recruiting methods and enable a deeper look at the role retirement benefits play as a workforce management tool for K-12 education," said Gerald Young, SLGE senior research associate and author of the infographic.

Studies & Reports

Pew reviews investment return assumptions of state pension plans

This brief updates research published by Pew in 2017 and 2018 that provided data on asset allocation, performance, and reporting practices for funds in all 50 states. It explores the impact of continued slow economic growth on investment performance, as well as potential management and policy responses to lower returns. Finally, the brief highlights policies and solutions employed by well-funded plans, including the adoption of lower return assumptions, that have helped insulate the plans from economic volatility.
stock averages. The S&P 500 crossed 3,200 for the first time ever last week, hitting its seventh round-number milestone of 2019. While business investment slumped due to uncertainty surrounding the world's two largest economies, public market investors remained confident enough to put money into stocks. **CNBC**

**In years following a double-digit return, the average stock market return is 11.5 percent**

Since 1926, U.S. stocks have been up double-digits 54 times (not including 2019). The average return in the year following a double-digit gain was 11.5%. The year following those double-digit gains saw positive returns 39 times (72% of the time) and negative returns 15 times (28% of the time). **A Wealth of Common Sense**

**Administrative costs of local public safety pension plans in Illinois far exceed those of statewide plans**

The Illinois Teachers' Retirement System spent $77 on administrative costs last year for every educator and retiree participating in the pension program. But that was the lowest amount among the statewide pension plans, none of which spent more than $120 per participant for administration last year. ... The average cost to administer [local public safety] plans was $500 per participant. **Daily Herald**

**Perspectives**

"Administrators, consultants, and ideological zealots;" there's no need for a public pension plan to be fully funded

It has become the mantra of some pension fund administrators, financial consultants that benefit from such schemes and ideological zealots that government pension funds should be 100% funded. These individuals are wrong. A recent report from the highly respected Brookings Institution, "The Sustainability of State and Local Government Pensions: A Public Finance Approach," debunks this false narrative. Tom Sgouros also discusses these issues in his 2017 report for the Haas Institute at the University of California, Berkeley. **Joel Pafford in the Albuquerque Journal**

**Federal Focus**

Thanks to an IRS phone call, Mississippi retirees elected to legislature in November may draw a pension

Most people do not welcome a call from the Internal Revenue Service, but a recent telephone discussion with the IRS has cleared the way for Mississippi's retired public employees to serve in the Legislature and draw their pension. Early last year the PERS Board had voted to modify its long-standing regulation that prevented retired public employees from drawing their pension while serving in the Legislature, contingent on a private letter ruling by the IRS that the change would not negatively impact the system's qualified plan status. **Message from MS PERS Executive Director**

**Tweet of the Week**

For most **state and local governments**, retirement systems remain a relatively small portion of their...
Summary and critique by Alex Brown and Keith Brainard

For the nation as a whole, the portion of combined state and local government spending dedicated to retirement system contributions is just below five percent.

NASRA News Clips

January 8, 2020

In the Media

Declining births and increasing deaths lead US to slowest rate of population growth in 100 years

For the first time in decades, natural increase - the number of births minus the number of deaths - was less than 1 million due to an aging population of Baby Boomers, whose oldest members entered their 70s within the past several years. As the large Boomer population continues to age, this trend is going to continue. "Some of these things are locked into place. With the aging of the population, as the Baby Boomers move into their 70s and 80s, there are going to be higher numbers of deaths. That means proportionately fewer women of child bearing age, so even if they have children, it's still going to be less." AP

Census data and press release

Studies & Reports

S&P Global publishes outlook for US states

The lower-for-longer economic forecast coupled with the living-for-longer demographic trend has made some state pension plans credit-drivers. Compounding this, many state pension plans prudently continue to lower their assumed asset return assumption in order to reduce market risk, and accept that this leads to higher costs. Pension and OPEB challenges though are not uniform across the states. Whereas some states have very large current and future cost obligations, others are at or close to being fully funded with limited risk of escalation, so the effect on credit from this obligation can vary greatly.

Read the advisory (registration)

Tweet of the Week

This update provides figures for public pension contributions as a percentage of state and local government direct general spending for FY 2017, and projects a rate of spending on pensions on an aggregate basis for FY 2018.

CIO magazine publishes list of 100 most influential chief investment officers

The annual list for 2019 includes 24 public pension fund CIOs. See the list

Federal Focus

Summary of SECURE Act provisions that may affect governmental plans

On December 20, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law, which some have called the most comprehensive piece of retirement legislation in over ten years. Certainly, this may be true for private sector retirement plans and for small, unrelated employers now allowed to participate in a new type of multiple employer plan. However, there also are some significant provisions about which governmental plan sponsors and administrators must be aware.

Ice Miller

Nation's largest union for musicians seeks to cut pension benefits already earned

A number of factors have contributed to the fund's shortfall, plan officials and musicians said. It enacted a series of expensive benefit increases before 2000, and then suffered major losses in the recessions since. It made a series of bad investment decisions in recent years, which are now the subject of the lawsuit brought by the musicians. And the fund now pays out more in benefits to retirees - whose ranks have swelled - than it receives in contributions from currently working musicians and employers, draining the fund.

New York Times
Snapshots of This Week's FYI

1. Interest in ESG investing continues to increase and is a top priority for many institutional investors, according to a recent survey.

2. The new Kentucky governor has recently released an analysis of 2017 proposed public pension reforms, requested by the former governor and subsequently blocked from public release, showing a switch from the DB model to a DC approach for new employees would cost the state more over the long term.

3. What are the major sources of retirement income for older Americans, and how are they distributed by race or gender? A new report from the National Institute on Retirement Security (NIRS) answers this question, as well as how the three major sources impact the poverty status and material hardship of retired Americans.

Interest in ESG Continues to Grow

Interest in ESG investing continues to increase and is a top priority for many institutional investors, according to a recent survey. In addition, a new study released this month continues to suggest a link between a company’s ESG performance and its financial performance. Therefore, NCTR is hosting a members-only webinar on Thursday, January 16, at 3:00 PM EDT to explore institutional investor ESG trends; the fiduciary questions that are raised; and how plans deal with the implementation issues presented. Register now.

ESG—the letters stand for environmental, social, and governance—is an investment strategy whereby investors examine criteria within these three categories in addition to traditional financial measures. It has grown by more than a third to over $30 trillion during the last several years, representing more than a quarter of the world’s professionally managed assets. And a 2019 survey by NCTR commercial associate member State Street Global Advisors (SSGA) of more than 300 global institutional investors, predominantly private and public pension funds, confirms that ESG investing remains a top priority for many respondents.

Why is ESG relevant to asset owners? Research suggests incorporating material ESG factors, alongside traditional financial metrics, improves returns over the long term. For example, a new study released January 9 from ISS ESG, the responsible investment arm of Institutional Shareholder Services, documents a link between a company’s ESG performance and its financial performance. Specifically, it finds firms with high or favorable ISS ESG corporate ratings tend to be more profitable through an economic value-added lens.

But the SSGA survey finds that among the various factors leading to ESG adoption by institutional investors in North America, only one percent of respondents said it was for the purpose of generating higher returns. The top reason, cited by 59 percent, was because they saw ESG investing as a fiduciary duty—even though ESG critics raise concerns plan fiduciaries could be sacrificing investment returns trying to fulfill social/political policy goals ESG may reflect.

Clearly, then, there is a “mix of drivers pushing and pulling investors to or from ESG investing,” as the SSGA report on their survey puts it. Consequently, as they point out, “institutional investors cannot afford to ignore it—either for the risk that it may pose or, perhaps even more compellingly, the opportunities it presents.”

As part of the debate over ESG investing, there are also some recent developments in this space that investors may want to closely monitor. Rakhi Kumar, SSGA’s head...
of ESG investments and asset stewardship, and Alison Weiner, ESG investment strategist at SSGA, have identified five:

1. **The Sustainability Accounting Standards Board (SASB) will emerge as the leading global ESG disclosure framework.** ESG data should be financially material, consistently reported by companies, and comparable across peer firms, and an increasing number of investors and companies see SASB as a framework that can improve the quality of companies’ ESG reporting. “While absolute numbers of SASB reporting companies are relatively low at just above 100, we expect SASB to emerge as the preferred standard for investor-relevant sustainability disclosure in 2020,” according to SSGA.

2. **Consideration of ESG will be seen as a fiduciary responsibility.** As ESG data is increasingly based on financially material issues, it can be relevant to investment outcomes. Also, the increasing availability of SASB-aligned data provides investors with the ability to quantify and compare companies’ operational performance on the ESG risks and opportunities that matter most to their industry. “Collectively, both greater awareness and access to data are moving investors towards the view that considering ESG issues in the investment process is part of honoring one’s fiduciary duty,” SSGA argues.

3. **ESG strategies will become more complex.** SSGA says they are increasingly seeing the adoption of more complex ESG strategies, with investors beginning to set multiple ESG objectives within their portfolios. Furthermore, as ESG is increasingly incorporated into index portfolio construction, ESG investing will increase within active strategies. “This along with the evolving understanding of fiduciary responsibility means that active managers who do not incorporate ESG into their company due diligence and investment processes will need to explain why they do not see ESG as a portfolio risk or investment opportunity,” SSGA notes.

4. **Investors will need to own their approach to exclusionary screening.** Exclusionary screening typically involves giving a list of restricted securities to an investor’s asset manager. As these exclusions became more widely used, investors have grown to rely on third party ESG data providers for “screens” of the topics they wish to exclude. However, SSGA says that with greater awareness of challenges in ESG data, investors are now beginning to question the data and methodology powering their exclusionary lists, and SSGA is “seeing a growing number of questions about how different screens are constructed by different providers as well as the low correlation of names screened by different providers for the same topic.” SSGA believes that, due to these differences, as well as what they see as “the increased scrutiny of all ESG investment products by both regulators and activists,” it will become “increasingly untenable for investors to fully outsource their exclusionary screening methodologies and keep their involvement at arm’s length,” and more asset managers will be taking greater ownership of their exclusionary processes in 2020.

5. **ESG will become a mainstream boardroom issue, resulting in better infrastructure and ESG disclosure by companies.** In 2020, SSGA believes ESG will “top the agenda in the boardroom.” They expect to see companies collecting new types of data, building new reporting mechanisms, and focusing on their performance against these financial material issues in 2020.

But ESG investing, while it is increasing across the board, continues to be controversial. For example, Commissioner Hester Peirce (R) with the Securities and Exchange Commission (SEC) has criticized ESG for having no enforceable or common meaning, noting that while financial reporting “benefits from uniform standards developed over centuries, many ESG factors rely on research that is far from settled.” Indeed, she has said, “I think that should be part of the discussion, trying to figure out to what extent ESG might stand for ‘enabling stakeholder graft.’”
So, the more you know about the most recent thinking on ESG, the better prepared you will be to make decisions concerning it. Therefore, if you have not done so already, be sure to register for NCTR’s “ESG Investing” webinar today!

- **State Street Global Advisers**: “Into the Mainstream -- ESG at the Tipping Point”
- **Pensions & Investments**: “ISS Study Links ESG Performance to Profitability”
- **ETF Stream**: “State Street: Five ESG trends to Watch in 2020”

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### More Evidence of the Cost of Switching from DB to DC

The new Kentucky governor has recently released an analysis of 2017 proposed public pension reforms, requested by the former governor and subsequently blocked from public release. The analysis shows a switch from the defined benefit (DB) model to a defined contribution (DC) approach for new employees would cost the state more over the long term. As legislatures across the country consider new pension reforms, it is important they understand switching to DC plans is no “silver bullet” that can provide easy relief to pension funding challenges.

The 2017 analysis was originally asked for by the then-Governor of Kentucky, Matt Bevin (R), and examined his proposed pension reform legislation for the two plans for non-hazardous employees maintained by the Kentucky Retirement Systems (KRS). One of the key aspects of Bevin’s pension reform plan was to move new employees in KRS into DC plans instead of leaving them in the hybrid pension plan that was established in 2013.

The analysis, prepared by NCTR commercial associate member Gabriel Roeder Smith & Company (GRS), essentially found that while Bevin’s proposed changes would likely have saved Kentucky money in the short term, over the long term it would have cost state taxpayers more, with the DC plan costing an estimated four percent of employees’ salaries rather than the three percent under the hybrid plan. In addition, it would have provided fewer benefits for retirees.

The new Governor, Andy Beshear, said he released the actuarial report to let employees and taxpayers “know the truth” about Bevin’s plan, even though it was not implemented because the legislature developed their own plan. “After years of waiting, the people of Kentucky now know the proposed 2017 pension reforms would have left the Commonwealth worse off,” Beshear said in releasing the analysis, which Bevin had blocked from being disclosed at the time it was prepared, calling it just a draft and therefore not subject to the state’s Open Records Act.

The analysis indicated that over 30 years, the path to full funding of the pension liability would be longer under Bevin’s proposal (rather than current law) and the rise in funded ratios would occur more slowly. Furthermore, the analysis pointed out closing the existing plan to new employees would have been costly over the long term because the closed plan would continue to pay benefits to retired members for many years but would have fewer employees paying into it. “It is reasonable to conclude that the employer contributions will need to increase to offset the lost earnings,” GRS noted.

Beshear was the Kentucky Attorney General the past four years and took Bevin to court to win release of the GRS analysis. However, even though Franklin Circuit Court Judge Phillip Shepherd said in a ruling in 2019 it should be released, Bevin subsequently appealed and received a stay of Shepherd’s order from the Kentucky Court of Appeals.
The GRS analysis of the Kentucky “reforms” is not the first time a DC conversion has been shown to be more costly to a plan sponsor than the DB plan it was to replace. For example, in August of last year, the National Institute on Retirement Security (NIRS) released updated case studies on Alaska, Michigan and West Virginia and created a new study on Kentucky. All these states switched new employees to DC-only accounts for the purported purpose of dealing with pension underfunding and rising costs. However, NIRS found the changes increased overall costs for the states, did not address existing pension underfunding and led to a loss of retirement security for employees. Indeed, NIRS found the switch exacerbated pension funding problems and increased pension costs to employers and taxpayers. Nevertheless, the Kentucky GRS study is still significant since it was sought by the sponsor of the proposed conversion. Also, the timing of its release is important because 46 state legislatures will convene this year, and as of last week, almost half of them have already begun their legislative sessions. The newly-released GRS study provides an important warning for legislators who think a DB-to-DC conversion is a simple and seemingly magical solution – a silver bullet – that can solve the complicated challenges associated with pension funding.

NCTR members in states where such pension “reform” efforts may be underway may therefore want to make sure key stakeholders are aware of this GRS analysis.

- *Chief Investment Officer:* “Kentucky Analysis Dispels Myth of 401ks as Pension Saviors”
- GRS 2017 Analysis of Bevins Pension Reform Proposal
- NIRS: “Enduring Challenges: Examining the Experiences of States that Closed Pension Plans”

### New NIRS Report Examines Sources of Retirement Income

What are the major sources of retirement income for older Americans, and how are they distributed by race or gender? A new report from the National Institute on Retirement Security (NIRS) answers this question, as well as how the three major sources – Social Security, Defined Benefit (DB) plans and Defined Contribution (DC) plans, alone or in combination – impact the poverty status and material hardship of retired Americans. According to the Social Security Administration, nearly 90 percent of Americans age 65 and older receive Social Security benefits. And although pension coverage has declined in recent years, NIRS notes 22 percent of all workers in the United States participated in a pension plan in 2017. Finally, based on the U.S. Bureau of Labor Statistics, 64 percent of private sector workers in 2018 had access to DC plans, either alone or in combination with a DB pension.

Relatively few retirees (6.8 percent) have income from all three sources. In its recent report, NIRS examines what sources of income retirees do have. The report is focused on households where the head of the household is age 60 or older and no one in the household works 30 or more hours per week—NIRS points out this is important because the economic security of older households with full-time workers may be due more to their employment income than their retirement income. The NIRS analysis and report, entitled “Examining the Nest Egg: the Sources of Retirement Income for Older Americans,” first determines what percentages of older households receive income from these various combinations. Then it examines these
income combinations along several different demographic characteristics: gender, race, age cohort, net worth, and educational attainment.

In order to get a sense of how pre-retirement income and wealth affects income in retirement, NIRS next considers the amounts of retirement income in the context of the net worth of the individual (excluding retirement savings from net worth). This is done in order to determine if it serves as an indication of whether those individuals with high pre-retirement earnings are benefitting from certain combinations of retirement income more than low-income or middle-income earners.

Finally, the NIRS analysis looks at how the different combinations of retirement income impact poverty status and material hardships in retirement. As part of this, NIRS evaluates how likely individuals are to experience poverty and various measures of material hardship depending on which combination of retirement income they receive.

NIRS concludes the source and combination of retirement income can have a profound impact on whether an older person is likely to be poor or experience a material hardship. Also, the analyses support the argument for a three-legged stool of retirement savings, namely, the more sources of retirement income a household has, the more total retirement income they are likely to have. “This highlights the importance of plan access for achieving retirement security,” NIRS stresses. “If workers do not have access to a retirement savings plan through their employer, they are much less likely to save for retirement and will have less income in retirement as a result,” the report underscores.

NIRS also concludes Social Security has a very important and powerful role to play in preventing elder poverty, but Social Security alone is not enough to provide a secure retirement, even though the largest share of older households only receive income from Social Security. “Protecting, strengthening, and expanding Social Security should be a top policy priority for those who are interested in retirement security,” NIRS stresses.

Even though the new report does not directly relate to public pensions, there are some key takeaways that can be useful for governmental plans, as Tyler Bond, NIRS' Research Director points out. For example, the report documents DB pensions continue to have an important role to play in reducing elder poverty.

Furthermore, the NIRS data suggests that older households, regardless of the combination of income sources, receive more retirement income from DB plans than DC plans. In addition, high-net worth individuals are more likely to receive income from DC plans, which means the latter have less of a poverty-reducing effect in retirement. Therefore, DB Pensions “serve an important function in keeping working families in the middle class in retirement,” NIRS notes.

NIRS also finds education, lifetime earnings, and retirement income all appear to move in conjunction with each other. That is, the more education someone has, the higher income they are likely to earn during their careers, which means they are likely to have more income in retirement. Also, due to issues of plan access and eligibility, those with higher incomes while working are more likely to have access to all three retirement plan types (DB, DC, and Social Security).

NIRS concludes plan access serves as a multiplier of income inequality over time and recommends retirement experts and policymakers “should consider the intersection of education, income, and retirement savings and how these factors may be driving diverging life expectancies among older Americans.”

NIRS will be holding a webinar on their new report Wednesday, January 15, from 2:00 PM - 3:00 PM EST.
In the Media

Ohio PERS board seeks two-year COLA freeze

The changes would shave $3.44 billion off the Ohio Public Employees Retirement System's $24 billion unfunded liability, the amount the system will need to make up to cover future benefits. ... OPERS is the Buckeye State's largest public pension system, representing about 213,000 retirees and 304,000 workers in municipal, county and state offices. Teachers, firefighters, state troopers and police officers have separate systems. Those four other pension plans have the autonomy to increase member contributions or lower cost-of-living adjustments, but OPERS does not.

Columbus Dispatch
Cost-of-Living Adjustments@NASRA.org

Some public pension boards must deal with bad trustee behavior

After the global financial crisis, which put the very existence of public pension plans into question, bad board behavior ranged from board members pushing anti-defined-benefit-plan agendas and harassing staff, to unauthorized communication with money managers and a general lack of civility and mutual respect.

Pensions & Investments (subscription)
Governance@NASRA.org

Studies & Reports

Local government employment rose in December as state government employment declined

The U.S. Bureau of Labor Statistics reported that state and local governments added an estimated 6,000 jobs in December 2019, with 14,000 additional local government jobs offset by 8,000 state government job losses. December 2019 marked the seventh consecutive month of improvement in aggregate state and local employment. Revisions to prior months' data added 2,000 local government jobs and subtracted 6,000 state government jobs from the running total.

Employment@NASRA.org

S&P Global publishes 2020 local government outlook

In 2020 we expect to see a continuation of the trend of many local governments limiting payment deferrals by adopting more conservative amortization methodologies. Unrealistic assumptions cost much more in the long run, particularly if aggressive assumptions result in systematic underfunding that is allowed to compound over many years, generating a much larger problem down the road. We expect local governments will continue to address the funding needs of pensions despite increasing near-term costs for sponsors. Read the outlook

Tweet of the Week

NASRA provides a compendium of resources and data about the broad public pension community.

Multiple investment houses are warning that the 60/40 investment model is dead

The prime reason for shoving aside the 60/40 strategy is lower returns from bonds. ... "Lower returns from bonds create a challenge for investors in navigating the late-cycle economy," according to JPMorgan's latest Long-term Capital Market Assumptions report - its 24th - written by David Kelly, John Bilton and Pulkit

NIRS study finds heavy reliance on Social Security among older Americans

A large portion (40 percent) of older Americans rely only on Social Security income in retirement while only a small percentage of older Americans (seven percent) receive income from Social Security, a defined benefit pension, and a defined contribution account. Retirement income from these three sources is widely considered to be the ideal situation to ensure retirement security, particularly for the middle class. Retirees with these three sources of income are far less likely to face poverty and economic hardship.
Sharma. "The days of simply insulating exposure to risk assets with allocation to bonds are over."

**Federal Focus**

**New law lowers age for permissive in-service distributions**

The Bipartisan American Miners Act, which was part of the recently enacted year-end appropriations bill, included a revenue provision that reduces the minimum age for permissive in-service distributions from qualified retirement plans and governmental 457(b) plans to age 59½. This change is applicable to plan years beginning after December 31, 2019. Under prior law, a qualified 401(a) plan could allow in-service distributions at the plan's normal retirement age or age 62. For 457(b) plans, in-service distributions were not permissible until the participant reached age 70½. This change is optional for those plans seeking to reduce the age for in-service distributions.

**Unexpected passing of Chris Allen, lead Republican aide to the U.S. Senate Finance Committee**

Chris Allen, Senior Advisor for Benefits and Exempt Organizations for the United States Senate Committee on Finance majority staff, sadly and unexpectedly passed away last week. Chris was an advocate on state and local finance and public pension policy for over 20 years, not only in his positions as a senior staff person in the U.S. Senate, but also his former roles as director of federal relations for the National Association of State Treasurers and the Financial Accounting Foundation. He will be a sorely missed friend and colleague. A memorial service will be held for him in the Senate this Friday.

**Perspectives**

**Josh McGee: The Texas Pension Review Board is a model for nationwide pension reform**

Poor decision making, rather than investment performance, has driven the huge run-up in pension debt and taxpayer costs. Any lasting pension reform that comprehensively addresses the current problems must improve decision making about public pensions. The Texas Pension Review Board is a model that other states should consider for restoring the financial soundness of their public pensions. PRB has increased transparency, oversight, and accountability, and its efforts have led to concrete positive improvements that are paying dividends for Texas's taxpayers and current and future retirees.

**Common retirement terms research says don't resonate well**

It was amazing to discover that some terms I considered "participant-friendly" are not so friendly after all! This study is a good reminder that all phrasing in participant communication should be carefully chosen to ensure that it is engaging. Testing a piece with a group of participants who have little-to-no retirement plan knowledge is a good way to work out the terminology bugs before releasing participant communication to the entire intended audience.

**Press release and study**

Forbes

Manhattan Institute

Texas Pension Review Board

Roll Call