NASRA & NCTR alerts – March-May 2020

NASRA News Clips

March 18, 2020

In the Media

CalPERS board members will be separated from each other and their audience

"Per guidance from public health officials for Sacramento County, we have fully implemented social distancing guidelines for public meetings, which includes our committee and board meetings next week, Marcie Frost, the pension system's chief executive officer, said in a letter to board members obtained by CIO. The radical change will affect the meeting of the CalPERS Investment Committee set for Monday and the full 13-member board meeting set for March 18. **CIO**

CDC guidelines for schools, workplaces, and community locations

Italian man sports social distance doughnut

What investment advisors are saying about the pandemic

A sample of observations regarding the pandemic and its fallout, from three investment advisors.

Goldman Sachs in ZeroHedge

Lazard Asset Management

Segal Marco Advisors

Global S&P webcast tomorrow on effects of virus on public finance

Dr. Bronner: The effects of this market decline will pass

"You can't be going crazy every time the market goes up and down," Bronner said. "It went up for almost 12 years straight. So, it's anticipated. I was here in October of '87, which was worse than this." **AL.com**

Tweet of the Week

A pension plan **funding policy** describes how pension benefits will be financed. State pension funding policies typically come in the form of statutes and retirement system board policies and practices.

Studies & Reports

Aggregate value of public pension assets reached all-time high of $4.82 trillion in fourth quarter of 2019

The Federal Reserve reports that the aggregate value of public pension assets as of the fourth quarter of 2019 was $4.82 trillion. This represents an all-time high, and an increase of 5.5 percent, from $4.57 trillion, above the prior quarter. The 2019 year-end figure is higher from the same quarter one year ago by nearly $650 billion, or 15.6 percent. Given recent declines in global equity markets, the 2019 year-end figure is likely to mark the high-water point of the aggregate public pension asset value for the foreseeable future.

Public Pension Assets@NASRA.org

Federal Focus

Social Security offices will only offer phone service

The U.S. Social Security Administration has announced that all local Social Security offices will be closed to the public for in-person service starting Tuesday, March 17, 2020. "This decision protects the population we serve -- older Americans and people with underlying medical conditions -- and our employees during the Coronavirus (COVID-19) pandemic. However, we are still able to provide critical services. Our secure and convenient online services remain available at www.socialsecurity.gov. Local offices will also continue to provide critical services over the phone." **Press release**

COVID-19 response bills moving through Congress

Phase 1 was a bill spurring coronavirus vaccine research and development. Phase 2 is a package that has passed the House and is expected to be taken up by the Senate to give tax credits to the self-employed and require governments and many businesses to provide paid sick and family leave (with a tax credit applied to what the company or nonprofit normally pays for each employee's Social Security). Phase 3

Public pensions among best places for women in institutional investment

Roughly 46 percent of total staff employed at foundations are female, according to new analysis by data firm Preqin. By comparison, women hold 27.8 percent of jobs across all institutional investors, Preqin said. Other allocators with higher levels of women employees included endowments, where 40.6 percent of staff are female, and public pension funds, where women account for 34.7 percent of employees. **Institutional Investor**

legislation is under development and may include direct payments to Americans and aid to troubled industries. **Washington Post** **Politico** **Vox**

Job Postings

- Senior Manager, Operations Support Services, Orange County Employees Retirement System
- Executive Director, Public Schools Retirement System of the City of St. Louis

For details on open positions, visit **Careers @ NASRA.org**

NCTR FYI: March 17, 2020

Snapshots of This Week's FYI

1. Net-of-fee performance across public pensions investing in the same private equity fund vary widely, according to a new academic study. Its findings suggest similar pensions consistently pay different fees, meaning many would collectively have earned billions of dollars more had they received the best observed terms in their respective private equity funds.
2. Government-sponsored defined contribution (DC) retirement plans, important components of public employees' overall retirement security, are the subject of several new actions of note.
3. The spread of the Coronavirus (COVID-19) is the dominant focus of the nation, and public pensions plans, their employees and their participants, are not exempt from its impact.

New Research Finds Public Pensions "Fail to Optimize" When Making Decisions on Private Equity Fees

Net-of-fee performance across public pensions investing in the same private equity fund vary widely, according to a new academic study. Its findings suggest similar pensions consistently pay different fees, meaning many would collectively earn billions of dollars more had they received the best observed terms in their respective private equity funds.

The new research was conducted by Juliane Begenau with Stanford University's Graduate School of Business, and Emil Siriwardane from the Finance Unit of the Harvard Business School. They begin by acknowledging state and local defined benefit (DB) pensions have increasingly shifted capital out of traditional asset classes into private-market investment vehicles like private equity and venture capital over the last two decades. This shift, they point out, "has been accompanied by an intense public policy debate over the fees charged by the general partners (GPs) of private market funds. "

However, while investment costs in private markets are conceded to be large, the two authors note there is "almost no systematic evidence on how they are determined, mainly because fees are privately negotiated, rarely observed, and often not even recorded." Therefore, the research examines the costs, in terms of management fees, performance fees, and any other costs that are borne by investors, that public pensions face when investing in private markets.

In order to compare the net-of-fee cash flows received by different pensions invested in the same private-market fund, the researchers used detailed pension portfolio data from 1990 to 2018. This approach is used in order to overcome what they refer to as "inherent data opacity issues."

The variation in these net-of-fee returns within funds shows public pensions investing in the same private-market fund "can experience very different returns." In the aggregate, they find pensions could have earned $8.50 more per $100 invested had they each received the fee structure of the best observed pension in their respective funds. Based on the study's sample—which covers roughly $500 billion of investments made by 200 U.S. pension funds into 2,600 private-market funds—public pensions could have earned nearly $45 billion more on these investments.

Moreover, the research shows "consistent winners and losers" to the extent some pensions systematically pay more fees than others, even when investing in the same fund. This means some pensions could have earned as much as $15 more per $100 on their investments over the study's sample.

Why? Size, relationships, and governance account for some of the reasons, the authors suggest.

For example, the researchers found evidence that larger pensions (as measured by overall assets under management) with stronger ties to the general partner (GP) of a fund tended to outperform other investors in the fund. This could be the result of their being better informed about GP skills than other plans, and this allows them to ask for reduced fees "because their capital commitment will send a positive signal to less informed investors. "

Pensions that have more member representation on their boards were also found to appear to pay lower fees. One reason for this, the authors suggest, may be "because more member representation lowers agency frictions at public pensions."

Nevertheless, the authors found controlling for pension characteristics "does little to change which pension funds stand to gain the most and how much they would gain if they paid similar fees as the best performing investors in our sample."

So why do two seemingly similar pensions choose different fee structures when investing in the same fund? The research suggests several possibilities:

- Pensions may agree to pay different fees because they differ in their information about manager skills. This would allow GPs who want to maximize profit to charge different fees, offering investors a menu of fee structures from which to choose. If investors "are aware of who is more or less informed, GPs might also offer fee breaks to more informed investors in order to attract less informed investors into the fund," the researchers point out. However, they also note while size and relationships correlate with lower fees, "they cannot fully account for any informational edges, signaling effects, or LP-GP synergies that might cause fees to vary within funds." This may mean some investors have expectations about the gross return of the fund that comes from outside sources, the researchers say.
- A "failure to fully internalize the cost structure of private market investments" could also be a reason, according to the authors. For example, less than five percent of pension investors in their sample have any mention of performance fees or carry in their annual report, "despite the fact that we find differences in carry to be an important component of price dispersion," they note.
- Poor negotiation skills or "agency frictions" are also offered as possible reasons. The report also notes "some evidence that frictions in labor markets and political considerations distort public pension investment decisions" in this area.

As the authors point out, "one might expect that rationally behaving pensions with similar attributes (e.g., size or experience) should in principle have similar information, expertise, and bargaining power." This should mean they pay similar fees when investing in the same fund.

However, differences in willingness to pay across pensions "appear systematic and largely unexplained by easily-observable pension characteristics," the report says.

The bottom line? "While it is difficult to unequivocally prove that pensions are not fully optimizing, the notion that they fail to do so on behalf of their beneficiaries is consistent with prior research on agency and labor market frictions at public pensions," the authors conclude. In short, this new study points to a failure of public pensions to make optimal choices on fees related to their investments in private equity.

- Begenau and Siriwardane: "How Do Private Equity Fees Vary Across Public Pensions?"

Focus on Public Employee Supplemental Savings Plans

Government-sponsored defined contribution (DC) retirement plans are important components of public employees' overall retirement security. Therefore, new legislative efforts to deal with Section 403(b) plan investing options, as well as proposed changes in accounting and financial reporting rules for Section 457 plans, will be of interest to NCTR members.

Section 403(b) Proposed Legislative Changes

As retirement systems across the nation have engaged in pension reform over the last decade, one aspect of such reforms often has involved the creation of a new tier of benefits for new hires. Typically, these new tiers provide a lesser benefit at retirement for new teachers and other public employees. Consequently, supplemental retirement savings opportunities are all the more important for them in ensuring an adequate income in retirement.

For many teachers, this supplement savings vehicle often takes the form of a 403(b) plan. It is therefore critical that such plans have the opportunity to be as successful as possible, providing the best returns on investments at the lowest possible cost.

However, there are certain legal and regulatory constraints that are imposed on public employees' 403(b) plans that can thwart this important goal. Specifically, one valuable investment option – known as a collective investment trust (CIT) – is unavailable to them.

Many CITs are pooled investment vehicles managed collectively in accordance with a common investment strategy. Unlike mutual funds, which are typically maintained by an asset management company and available to most retirement plans and retail investors, many CITs are maintained by a bank or trust company and can only be offered to certain qualified retirement plans, including 401(k) plans, church 403(b) plans, and 457 plans, but not 403(b) plans. According to Vanguard, the cost savings to 403(b) participants in plans that offer CITs could amount to as much as $250 million per year.

Therefore, for some time now, there have been efforts to address this inequity, and NCTR held a members-only webinar in March of 2017 to discuss these activities and their importance to teachers.

Now, new bipartisan legislation has been introduced in the House of Representatives to level the playing field and ensure public sector and non-profit retirement-savings programs have the same access to low-cost investments as do for-profit retirement plans. The legislation, H.R.6257, was introduced by Congressman Jimmy Panetta

(D-CA) on March 12. It is cosponsored by Congressmen Ron Estes (R-KS), Brendan Boyle (D-PA), Darin LaHood (R-IL), Madeleine Dean (D-PA), and Andy Barr (R-KY).

The bill is a companion to Section 117 of the Retirement Security and Savings Act (S. 1431), introduced by Senators Rob Portman (R-OH) and Ben Cardin (D-MD) in May of 2019. It has been endorsed by the National Association of Government Defined Contribution Administrators (NAGDCA) as permitting their members to provide “a more robust array of investment options at lower costs, providing the potential for increased retirement asset growth for plan participants,” according to a NAGDCA press release announcing their support for the bill.

“Lack of access to the same breadth of investment structures long available to other types of governmental DC plans is costing 403(b) plan participants potentially thousands of dollars in retirement savings due to higher investment expenses and reduced returns and impeding 403(b) plan sponsors’ ability to build powerful, talent-attracting plans,” according to NAGDCA Executive Director Matt Petersen.

The likelihood that the legislation can be approved this Congress is linked to the chances for consideration of another major retirement bill, often referred to as the “SECURE Act 2.0,” a reference to the major retirement package that became law last December. Although Congressman Richard Neal (D-MA), Chairman of the House Ways and Means Committee, has said he intends to act on legislation in this area in 2020, the challenges of doing so in an election year may prove to be formidable.

Section 457 Accounting and Financial Reporting Rules

On March 9, the Governmental Accounting Standards Board (GASB) issued a proposed Statement that would, among other things, “enhance the relevance, consistency, and comparability of accounting and financial reporting for Section 457 deferred compensation plans that meet the definition of a pension plan and for benefits provided through those plans.”

In other words, a Section 457 plan that meets the definition of a pension plan in paragraph 51 of GASB Statement 67, “Financial Reporting for Pension Plans” (or paragraph 128 of Statement No. 73, which applies to pension plans not administered through an irrevocable trust) is considered to be a pension plan for accounting and financial reporting purposes, including for purposes of determining whether that Section 457 plan should be reported as a fiduciary activity.

Thus, if a Section 457 plan that meets the definition of a pension plan is included in the financial statements of another government or issues stand-alone financial statements, all accounting and financial reporting requirements that are relevant to pension plans should be applied.

The proposal also is intended to increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which the organization does not have a governing board and the primary government performs the duties that a governing board typically performs.

Finally, the Exposure Draft, “Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans,” is also “designed to mitigate financial reporting costs associated with certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and other employee benefit plans.”

Comments are due by April 10, 2020.

- Press Release: “Congressman Panetta Introduces Public Service Retirement Fairness Act”
- Wealth Management.com: “House Bill Seeks to Improve 403(b) Investment Options”
- NAGDCA: “NAGDCA Endorses Public Service Retirement Fairness Act to Amend IRC Section 403(b) to Expand Investment Options”
- GASB: “Gasb Issues Proposal Addressing Certain Component Unit Criteria and Section 457 Deferred Compensation Plans”
- *PlanSponsor*: “GASB Proposes New Reporting Rules for 457 Plans”

Ice Miller Offers Coronavirus Resource Center

The spread of the Coronavirus (COVID-19) is the dominant focus of the nation, and public pensions plans, their employees and their participants, are not exempt from its impact. The key is to be prepared. Certainly, medical concerns are the top priority, but there are also legal, regulatory and business ramifications of the pandemic that must also be understood and dealt with.

Ice Miller LLP, an NCTR commercial associate member, has organized a COVID-19 Task Force to help educate their clients about their risks and their business' risks due to COVID-19. It attempts to address how the coronavirus will impact business functions and what steps can be taken to mitigate that impact.

These resources include:

- Steps to Address Coronavirus in Your Workplace
- Coronavirus and Worker's Compensation
- COVID-19 and Business Interruption Insurance
- 6 Tips for Remote Working as COVID-19 Spreads
- Coronavirus Disease (COVID-19) - A Force Majeure Event?
- European Travel Suspension Implications
- HDHPs Can Cover COVID-19 Testing and Treatment Without Cost-Sharing
- COVID-19 Litigation Trends
- Be Wary of Coronavirus Scams
- The Impact of COVID-19 on Landlord-Resident Relationships
- OSHA Recording Requirements for Work-Related COVID-19 Cases

Ice Miller has also prepared initial information on the Families First Coronavirus Response Act passed by the House of Representatives on March 13, 2020; it is expected to be considered by the Senate this week. The legislation contains:

- Amendments to the Family and Medical Leave Act (FMLA)
- The Emergency Paid Sick Leave Act, which, if passed as written, will require private employers with fewer than 500 employees (that engage in commerce or be in an industry that affects commerce) and **all public employers** to provide emergency paid sick leave related to the coronavirus, beyond any amounts already accrued by the employee under other paid time off policies.
- Tax Credits for Emergency Paid Sick and Paid Family and Medical Leave

Finally, the Ice Miller Resource Center provides important links to national, state and local resources, including, but not limited to:

- Centers for Disease Control and Prevention (CDC)
- Interim Guidance for Business and Employers
- Interim Guidance for Mass Gatherings or Large Community Events
- Interim Guidance for Health Care Facilities
- Interim Guidance for Community and Faith-Based Organizations
- Interim Guidance for Higher Education Administrators
- Interim Guidance for K-12 and Childcare Program Administrators
- Strategies to Prevent the Spread of COVID-19 in Long-Term Care Facilities
- Information for Travel
- World Health Organization (WHO)
- Get Your Workplace Ready
- Centers for Medicare & Medicaid Services (CMS)

NCTR is also creating a location on its website where materials prepared by NCTR members that are being used in managing the impact of the pandemic will be housed and made accessible to other NCTR members.

Be smart. Stay safe.

- Ice Miller: "Coronavirus (COVID-19) Resource Center
- Ice Miller: "House Passes Families First Coronavirus Response Act"

National Council on Teacher Retirement / 9245 Laguna Springs Dr., Suite 200 / Elk Grove, CA 95758 / (916) 509-7260

www.nctr.org

NASRA News Clips

April 8, 2020

In the Media

Pensions & Investments: Public pensions face new round of woes

NASRA's Mr. Brown said it's going to take a while before the long-term impact of all of this is known.

Studies & Reports

State and local governments reversed eight consecutive months of employment gains in March

"One should remember that these losses and gains are phased in over several years. We won't know what the returns will be until the fiscal year ends, and so it's going to take a little while."

Read the article (subscription)

New York Times: Coronavirus has the public pension time bomb ticking faster; NCPERS responds

Already chronically underfunded, pension programs have taken huge hits to their investment portfolios over the past month as the markets collapsed. The outbreak has also triggered widespread job losses and business closures that threaten to wipe out state and local tax revenues. That one-two punch has staggered these funds, most of which are required by law to keep sending checks every month to about 11 million Americans.

Mary Williams Walsh
NCPERS letter to the editor

Market decline allows Oregon PERS to test new investment strategy

"We hit for power. We were sluggers. We were the Barry Bonds of public pension funds. We would often go up and hit a home run or strike out," [CIO] Skjervem told the PERS board. "But we have worked really hard to change that distribution. We have given up power for average. We are not swinging for the fences as much as we used to. We hope we are not striking out as much, and we are focusing not on slugging percentage, but on on-base percentage.

Portland Tribune
Oregon PERS Statement of Investment Objectives and Policy Framework

New Jersey governor waives return-to-work restrictions on retired public workers to increase anti-virus workforce

According to the executive order, "For the duration of this emergency, retirees may return to employment by government agencies in any capacity, including but not limited to full-time employee, part-time employee, or special law enforcement officer, without having to re-enroll in any retirement system, if the following conditions are met: A. The retiree has retired before

The U.S. Bureau of Labor Statistics reported that state and local governments lost an estimated 6,000 jobs in March 2020, with 8,000 local government additions offset by 14,000 state government losses. March 2020 marked the reversal of eight consecutive months of increase in aggregate state and local employment. Because the BLS survey measures pay periods that include the 12th day of the month, this update predates much of the virus-related economic response.

Employment@NASRA.org

Federal Focus

IRS reverses course on automatic stimulus payments to seniors

The U.S. Treasury announced that Social Security recipients will not have to file tax returns in order to receive stimulus payments. The reversal came after complaints from lawmakers that requiring seniors to file would place an undue burden on them amid shutdowns and social distancing. While efforts are still underway to determine if automatic payments can be made to non-SS low-income seniors, individuals with no taxable income are encouraged to use the IRS' Free File Program, an expected simplified IRS rebate form, or new portals being developed by tax preparers, such as Turbotax.

Politico
Ways and Means updated FAQ
IRS' Free File Program
Turbotax Economic Impact Payment Portal

Phase 4 stimulus and pensions

Shoring up multiemployer pension solvency was nearly included in the $2 trillion CARES Act package enacted last month and was expected to be back on the table for the next stimulus bill. However, early signs aren't encouraging for a bipartisan compromise coming together and opponents to pension plan loans continue to claim that public pensions will be next in line. While most multiemployer plans are likely to recover in the long term, some were severely underfunded going into the COVID-19 crisis and rising unemployment and investment losses will have a significant impact all multiemployer pension plans.

Bloomberg Law
Segal Post-COVID-19 Multiemployer Outlook

the date of this Order; and B. The retiree has completed at least a thirty-day separation from their employer, from the date of retirement or the date of Board approval, whichever is later; and C. The retiree's return to employment is needed because of the COVID-19 pandemic."

NJ.com

Pennsylvania SERS waives required minimum distributions and offers tax-free early withdrawals from DC plan

"Today's action allows SERS deferred comp participants to take early distribution withdrawals on a tax-penalty-free basis from their personal accounts to help them meet their immediate needs with the option to repay that money within three years," explained SERS Executive Director Terrill (Terri) Sanchez. ... Participants who qualify may request a distribution from their account of up to $100,000 or the balance of their account, whichever is less.

See the press release

Daily Signal

Tweet of the Week

Core elements of a **public pension funding policy** are the actuarial cost method, the actuarial funding method, and the amortization policy.

Job Postings

No new listings

For details on open positions, visit
Careers @ NASRA.org

Snapshots of This Week's FYI NCTR April 7, 2020

1. Although COVID-19 recovery rebate checks have recently been approved for all U.S. residents or citizens who are not the dependent of another taxpayer and who have a work-eligible Social Security Number, many people are left with questions.
2. Governmental pension plans are vigorously reacting to the impact of COVID-19, protecting the safety of system members and employees while ensuring continuity of their operations in the face of stay-at-home orders affecting an estimated 90 percent of the country.
3. The current market turmoil has sparked a renewed discussion of pension obligation bonds (POBs) and their potential use at this time as part of a funding strategy. However, it is also well to keep in mind some of the downsides of this approach.

Recovery Rebate Checks: What Your Plan Participants Need to Know

Although COVID-19 recovery rebate checks have recently been approved for all U.S. residents or citizens who are not the dependent of another taxpayer and who have a work-eligible Social Security Number, many people are left with questions. Of primary concern is whether the payments will be made automatically or if they require a form to be filed first.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act authorizes rebate recovery payments of up to $1,200 ($2,400 married), with an additional $500 per child under the age of seventeen. The rebate is not considered income and is therefore not taxable. Also, the rebate is not counted when determining eligibility for means-tested Federal programs, such as Supplemental Security Income (SSI).

The amount of the payment is slowly reduced for those with gross incomes over $75,000 ($112,500 for head of household and $150,000 married), and is completely phased-out for single filers with incomes exceeding $99,000; $146,500 for head of household filers with one child; and $198,000 for joint filers with no children.

So, what does an individual have to do in order to receive the rebate payment?

The answer is, “It depends.”

Furthermore, understanding what factors the automatic payment depends on has been difficult to get a clear handle on. However, with the caveat that (i) the following is for informational purposes and should not be relied on for legal advice, and (ii) individuals should consult the Internal Revenue Service (IRS) or a tax advisor to address questions related to their individual circumstances; here are the current basics based on information from the House Ways and Means Committee, the Senate Finance Committee, and interviews with Congressional staff currently working on the issues involved with the processing of the recovery rebate checks.

Eligible Individuals Who Filed a Tax Return For 2019 or 2018

For most Americans, **no action** on their part will be required to receive a rebate. The IRS will use a taxpayer’s 2019 tax return if filed or their 2018 return if they have not yet filed their 2019 return. The payment will be made automatically, and adjusted accordingly—as noted above—based on their income as it appears on the return that is used. Finally, it has been reported rebate payments will be issued in reverse order of adjusted gross income, meaning that people with the lowest income will get payments first.

If individuals included direct deposit information with their filed tax return, they should get the payment into that account and it should be able to be delivered quickly. If they did not submit a direct deposit, a check will be sent automatically to the address used for the tax return. Hill staff note, “The process of issuing and mailing paper checks will take longer than direct deposit.” In addition, the IRS is soon expected to roll out an online portal where people can submit their direct deposit information to help them receive payments quicker.

Eligible Individuals Who Have NOT Filed a Tax Return For 2019 or 2018

Individuals who have not filed a tax return for 2019 or 2018 are still eligible to get a rebate. However, their ability to get one automatically depends on whether or not they are receiving Social Security benefits.

The SSA-1099 is a tax form that shows the total amount of benefits an individual received from Social Security in the previous year. It is mailed out each January to people who receive benefits and tells them how much Social Security income to report to the IRS on their tax returns.

When the CARES Act was passed, the Treasury Secretary was given the option, in the case of low-income Social Security recipients who may not have filed a 2019 or 2018 tax return, to instead use information from these non-filers' SSA-1099s for calendar year 2019 in order to automatically provide them a rebate payment instead of requiring them to file a tax return.

However, the IRS announced early last week it was not apparently exercising this option, saying some seniors and others who do not typically file returns will need to do so in order to receive a recovery rebate payment. Strong objection from both sides of Capitol Hill was swift in coming.

More than three dozen Democratic Senators, led by Senators Maggie Hassan (D-NH) and Sherrod Brown (D-OH), wrote Treasury Secretary Steven Mnuchin and Social Security Commissioner Andrew Sau to say they "strongly urge you to ensure that economic stimulus payments are automatically sent to vulnerable seniors and individuals who experience disabilities, without these individuals needing to file a tax return."

On the House side of the Capitol, House Ways and Means Committee Chairman Richard Neal (D-MA) also objected, calling on the Trump administration "to find a solution that will allow vulnerable groups to receive these funds automatically." Also, the Ranking Republican on the Ways and Means Committee, Kevin Brady (R-TX), raised strong objections.

The Treasury Department and the IRS quickly reversed themselves, agreeing that **Social Security beneficiaries who are not typically required to file tax returns will not need to file an abbreviated tax return in order to receive an economic impact payment**. "Social Security recipients who are not typically required to file a tax return need to take no action," said Mnuchin in a statement. Social Security recipients will receive the stimulus payments as a direct deposit or by paper check, just as they would usually receive their benefits.

Other individuals who have not filed for 2019 or 2018 AND do not receive Social Security benefits reported on an SSA-1099 form **will have to either file a tax return, even if they have little or no income, or a simplified form that Congressional staff report the IRS is currently in the process of developing**.

This past weekend, TurboTax announced if individuals qualify for a stimulus payment and are not required to file a tax return, and do not receive Social Security income, they “can e-file your IRS registration for free with TurboTax to receive your stimulus payment with our Stimulus Registration for non-filers.” Congressional staff confirm the TurboTax product was put together in conjunction with the IRS. TurboTax was first to market, but it is expected other tax preparation companies will be releasing similar products soon.

The IRS simple form will contain much of the same information as the tax preparation companies, but individuals will not have to create an account. Individuals will be able to complete the form and mail it in. However, “using the paper process will likely mean a much longer wait for a check,” Hill staff concede.

The IRS is reported to be ready to make about 60 million payments to Americans through direct deposit in mid-April using information for these individuals from their 2018 or 2019 tax returns. However, the IRS will not begin issuing paper checks until the week of May 4. The checks will be issued at a rate of approximately five million per week, meaning it could take up to 20 weeks to send all of the checks out—delaying some checks until the week of August 17, according to reporting in *The New York Post*.

Low-Income Non-Social Security Retirees

Unfortunately, **low-income retired public employees who do not receive Social Security will NOT automatically receive a recovery rebate without filing a tax return or simplified form**, unlike similarly situated Social Security recipients.

Public sector advocates tried throughout negotiations over the CARES Act to include recipients of 1099-R forms in the special treatment afforded SSA-1099 recipients, but were rebuffed by the IRS—who told Congressional negotiators it would be too difficult, administratively, to administer automatic payments to such individuals. They are continuing work with Staff to Chairman Neal and Congressman Brady, who are suggesting the IRS adopt this 1099-R approach.

However, **in order to assure they will receive rebate recovery checks, public sector retirees who do not file tax returns and who also do not receive Social Security benefits should be sure to either file a tax return or any simplified form the IRS releases** for the purpose of obtaining such payments.

The bottom line? More than 80 percent of U.S. taxpayers are expected to receive a stimulus payment this year. The best ways to ensure you receive a recovery rebate payment as soon as possible is to file a 2019 tax return (if you have not already done so—even if you have little or no taxable income) and submit your direct deposit information.

- Senate Finance Committee: “CARES Act: Recovery Check FAQ”
- House Ways and Means Committee Republicans: “CARES Act: Coronavirus Relief Check Questions Answered”
- *Accounting Today*: “IRS will allow coronavirus stimulus payments for seniors who don’t file tax returns”
- *New York Post:* “Some people may not get stimulus checks until August”

COVID-19 Increases Spotlight on Public Pensions

Governmental pension plans are vigorously reacting to the impact of COVID-19, protecting the safety of system members and employees while ensuring continuity of their operations in the face of stay-at-home orders affecting an estimated 90 percent of the country. At the same time, markets have been on rollercoaster rides, having lost more than a quarter of their value since hitting all-time highs in February, but currently surging, with historic gains on Monday. In the midst of the turmoil, public pension critics have seized on the moment to predict doom and gloom for the retirement security of millions of public employees.

According to a March survey by the National Association of State Retirement Administrators (NASRA) of its member systems' responses to the COVID-19 Pandemic, most systems report they are able to implement their monthly benefits payroll process entirely remotely; a few have a limited number of staff working at the office to effect the payroll. In addition, nearly all respondents said the retirement application process is fully automated, allowing staff to perform processing while working from home.

Also, nearly all respondents said asset and cash management is being performed seamlessly from investment staff working remotely. Respondents stated that enabling investment staff to work remotely was in place prior to the current threat, and that "little to nothing has needed to be changed in order to continue the investment operation," according to a NASRA summary of survey results. The process for ensuring continuity of investment operations can also include check-ins with vendors (such as investment managers, the custodial bank, etc.) to confirm the adequacy of their COVID-19 response.

(NCTR appreciates NASRA permitting the "NCTR FYI" to provide a link to the Survey summary, at the end of this story.)

Nevertheless, the focus of most press coverage has been on system investments and the "havoc on markets — and plans' portfolios" because of the pandemic, as money manager and reporter for *Pensions & Investments*, James Comtois, described in a recent *P&I* article.

Comtois notes the widely circulated estimates by Moody's Investors Service that U.S. public plans are generally on pace for an average investment loss of about 21 percent for the fiscal year ending June 30, with domestic public plans facing nearly $1 trillion in investment losses because of the economic fallout from the coronavirus. "These losses could exacerbate the pension liability challenges that many state and local governments already are facing," Comtois points out.

The economic setback is also reducing revenue levels and “threatening the ability of state and local governments to afford higher pension costs,” he writes, quoting Tom Aaron, vice president and senior analyst at Moody's, who warned that "[w]ithout a significant market rebound, that's going to result in some new unfunded liabilities that are going to be material and compounded on top of the already unfunded liabilities"—in turn, increasing government contribution requirements.

Aaron said, "given the already unfunded positions, if governments don't quickly increase their contributions, the longer-term consequences for pensions are severe."

However, the *P&I* reporter also notes some plans facing funding challenges have been preparing for a disruption in the markets. “And although none of them could expect a crisis such as COVID-19, they said they are at least better positioned to handle the resulting market volatility,” Comtois reports.

As an example, he looks at the Connecticut Retirement Plans & Trust Funds, the Chicago Public School Teachers' Pension & Retirement Fund, and the Kentucky Retirement Systems. All of them report they had what Shawn T. Wooden, state treasurer and principal fiduciary for the Connecticut system, described as “a clear sense that the market wasn't going to continue to roar for the next decade."

In short, as NASRA's research manager, Alex Brown, told *P&I*, “Pension plans that are poorly funded don't necessarily behave differently than other plans," and have “policies in place that take their funding position into account."

Comtois then examines the important issue of whether plans have enough cash on hand to pay benefits. He reports investment consultants with whom he spoke said the plans they have worked with are not repositioning their portfolios and already have enough cash to pay out obligations.

For example, he cites Callan’s Executive Vice President and Director of Capital Markets Research Jay V. Kloepfer, who said the big question plans should ask themselves is if they have enough liquidity. However, based on conversations with clients, Callan reports that has not been an issue. Kloepfer says "We've addressed liquidity pretty aggressively with most plans we've worked with, especially those in a challenged funding position."

Kloepfer also warns plans, even underfunded ones, "shouldn't be making sudden changes. You shouldn't be changing the wheels of the car while you're driving down the road," he said.

[NCTR is proud to have Callan as a member and an active participant on NCTR’s Corporate Advisory Committee.]

Comtois also spoke with Kristen Doyle, a partner and head of public funds at Aon—another valued NCTR Corporate Advisory Committee member. Doyle said many plans, particularly underfunded ones, "have a healthy allocation to investment-grade credit and cash, so parts of their portfolios will remain liquid."

"Allocations are based on funded status. They test these different portfolios against that liability structure and test it across multiple markets, including ones like this one," Doyle explained to *P&I.* According to Aon, plans they have worked with are not panicking, and those that are rebalancing are doing so "very carefully and prudently."

But none of this has stopped public pension detractors from going on the attack. American Enterprise Institute (AEI) resident scholar Andrew G. Biggs, long-time critic of public pensions in general and teacher plans in particular, told Comtois that, while the coronavirus was not predicted, "for years outsiders have warned that public-sector pensions have contributed too little, taken too much investment risk and failed to enact sufficiently far-reaching reforms." Biggs said it "was only a matter of time before something went wrong."

But nothing quite comes close to the attack on public pensions from *New York Time*s "reporter" Mary Williams Walsh. Walsh, who has been a critic of public pension plans for years, has often been criticized by past NCTR Executive Directors for failing in her reporting to reflect a balanced presentation of the facts about public pensions, but instead producing "opinion" pieces reflecting her personal views.

In her latest screed against public plans, entitled "Coronavirus Is Making the Public Pension Crisis Even Worse," Walsh begins her article by observing "For years, the country's public pension plans have faced a yawning gap between what they owe and what they can pay."

It goes downhill from there.

Walsh says, "public pensions are the time bomb of government finance." She argues the accounting rules governing public pension plans have made risk attractive to public plans, making it "simpler to put money in riskier assets and bet on rosy investment returns than to commit more taxpayer money upfront."

Without detailing her article's many assertions, suffice it to say the National Institute on Retirement Security (NIRS) has written to the *NYT*, saying her characterization of public plans as "time bombs" is bordering on "journalistic malpractice."

As NIRS points out in its letter:

- While the 2008 global market crash reduced public pension fund asset values from $3.15 trillion in 2007 to $2.17 trillion in 2009, as of the fourth quarter of 2019, public pension assets were $4.82 trillion, more than doubling their asset values in less than a decade after surviving the 2008 financial crisis (while at the same time also paying out an estimated $2.5 trillion in benefits during that same period, NCTR would add).
- NIRS analysis of U.S. Federal Reserve and U.S. Census Bureau public pension data from 1993 to 2005 found that public pensions followed well-established practices for prudent, long-term investing before, during, and after the 2001 market plunge, indicating public plans can recover from the coronavirus financial crisis in a manageable way. "The same cannot be said

for the millions of Americans who have seen their 401(k) accounts wiped out, especially for those with no time to recover," NIRS also notes.
- Walsh fails to understand the sizeable economic impact of pensions and how pensions can act as an "economic stabilizer" during volatile times because retirees with stable monthly pension income can continue to spend on basic needs, even during an economic downturn, which will be vital during this financial crisis.

The National Conference on Public Employee Retirement Systems (NCPERS) has also sent a letter to the *NYT* concerning the Walsh article that is even more direct. NCPERS Executive Director and Counsel Hank Kim, referring to the Walsh column as 'jaw-droppingly crass', points out, "in the middle of a crisis, when people are dead and dying and nations are spending tens of trillions of dollars to beat back a pandemic, her contribution to the public discourse is that the public pension sky is falling."

Kim notes that, in the middle of the global pandemic, public pension systems are issuing checks as they always do, providing stable income to retirees, powering spending in communities, and providing revenue to governments. "They are a source of calm and confidence in the midst of chaos," he says.

"Pensions are in it for the long haul," Kim argues, noting that, for more than 150 years, "public pensions have steadily delivered modest but reliable retirement income to millions of dedicated public servants like the nurses, doctors, and EMS personnel who are on the coronavirus frontlines."

He closes by pointing out pensions "have withstood and rebounded from crisis after crisis," and their focus right now is on "helping members through the turmoil and delivering on their promises." "If Ms. Walsh's contribution is to report on the trumped-up 'crisis' within public pensions, maybe she should take a breath and save precious space in *The New York Times* for truly valuable reporting on the coronavirus crisis," Kim concludes.

Public pensions will be an increasing target of attack. Critics will seize on this moment of crisis, as Walsh has, in order to frighten hard-working public employees—including teachers who are still on the job, working with students from home as best they can, as well as the staff of our retirement system members, who are doing all they can to see the nation's invaluable public employees through this national emergency. NCTR is working to do its part, too. Whether striving to protect public pensions from harm, inadvertent or otherwise, by the Congress and the Administration in response to such articles, or making sure that important member services, such as webinars, trustee training, and member communications are robustly maintained and improved--NCTR remains here for you.

Stay safe!

- NASRA: "Summary Overview of Responses to Survey on System Responses to COVID-19 Pandemic"
- *Pensions & Investments:* "Underfunded public plans facing a new round of woes"

- *NYT*: "Coronavirus Is Making the Public Pension Crisis Even Worse"
- NIRS: "NIRS Responds to *The New York Times* on Public Pensions"

Are Pension Obligation Bonds the Answer to the Current Crisis?

The current market turmoil has sparked a renewed discussion of pension obligation bonds (POBs) and their potential use at this time as part of a funding strategy. However, it is also well to keep in mind some of the downsides of this approach.

POBs are taxable bonds that some state and local governments have issued as part of an overall strategy to fund the unfunded portion of their pension liabilities by creating debt. As the Government Finance Officers Association (GFOA) explains, the use of POBs is based on the "assumption that the bond proceeds, when invested with pension assets in higher-yielding asset classes, will be able to achieve a rate of return that is greater than the interest rate owed over the term of the bonds." In other words, as it has been described by some, POBs may be seen, under the right circumstances, as offering an attractive "actuarial arbitrage."

This is exactly what is currently being argued by some at the current time. For example, Liz Farmer, research fellow for the Rockefeller Institute of Government and a former fiscal policy reporter for *Governing* magazine, recently wrote in *Crain's Chicago Business* she believes POBs, which can require "some luck" in terms of correctly timing investments made with the bond proceeds, may nevertheless be worth taking a chance on at this moment.

Farmer argues stocks "are cheap now, and so are borrowing costs." She also recommends the Federal government can "sweeten the deal" even more by making these bonds tax-exempt for qualifying governments, which would lower borrowing costs even more, noting that before the 1986 tax reform, these bonds were in fact tax exempt.

She thinks "a boost in assets now would likely produce a welcome return on investment over the next few years and ultimately help stabilize government pension bills."

Another recent call for POBs at this specific moment in time was made by Girard Miller in a commentary in *Pensions & Investments*. Miller, a retired investment and public finance professional and the former CIO of the Orange County Employees Retirement System, thinks the "time is ripe" for POBs, saying "It's finally now time for public pension funds and their sponsoring employers to make lemonade from lemons."

Miller thinks POBs "could never be more timely — and more vital to the future health of states and municipalities." He thinks the basic concept is relatively simple, and “has been used for 45 years.” But he also adds this has nevertheless had “sketchy results” because of what he calls “ill-advised timing.”

But he argues POBs “only work well if they're issued in the depths of a recession” and that, therefore, “now is the time.” "The plan sponsor has a liability with this, but they can stretch that out over 30 years if they need to," he insists.

However, others are not as enthusiastic. For example, Kristen Doyle, a partner and head of public funds at Aon (an NCTR Commercial Associate member) told *Pensions & Investments* "I don't think [pension obligation bonds are] an option in this market right now.” She explained, "It's a risky endeavor because you're assuming the pension will outperform the interest rate of the bond, and that's a huge gamble."

GFOA also has serious concerns with POBs. They have issued a “Pension Obligation Bond Advisory” which points out “POBs involve considerable investment risk,” and calls their goal “very speculative.” “Failing to achieve the targeted rate of return burdens the issuer with both the debt service requirements of the taxable bonds and the unfunded pension liabilities that remain unmet because the investment portfolio did not perform as anticipated,” their Advisory explains.

“In recent years, local jurisdictions across the country have faced increased financial stress as a result of their reliance on POBs, demonstrating the significant risks associated with these instruments for both small and large governments,” GFOA concludes.

Indeed, municipal bankruptcies, from Detroit to Stockton and San Bernardino, have involved POBs, and the Center for Retirement Research (CRR) at Boston College has also found “the jurisdictions that issue POBs tend to be the financially most vulnerable with little control over the timing.”

The GFOA therefore recommends that state and local governments do not issue POBs for the following reasons:

- The invested POB proceeds might fail to earn more than the interest rate owed over the term of the bonds, leading to increased overall liabilities for the government.
- POBs are complex instruments that carry considerable risk. POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives, which must be intensively scrutinized as these embedded products can introduce counterparty risk, credit risk and interest rate risk.
- Issuing taxable debt to fund the pension liability increases the jurisdiction’s bonded debt burden and potentially uses up debt capacity that could be used for other purposes. In addition, taxable debt is typically issued without call options or with "make-whole" calls, which can make it more difficult and costly to refund or restructure than traditional tax-exempt debt.
- POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the sponsor’s overall costs.

- Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls.

It is likely that the use of POBs will be increasingly debated in the coming days. Understanding both the pros and the cons will be very important.

As CRR concluded in its 2014 update on POBs, they can potentially be used responsibly by fiscally sound governments who understand the risks involved or could play a role as part of a broader pension reform package for fiscally stressed governments. But the results from CRR's update "suggest that POB usage to date has not followed this formula – think Detroit, which issued POBs in 2005 and 2006 just as the market was approaching a peak."

NCTR will keep you informed on these debates, as well as their outcomes.

- *Crain's Chicago Business*: "States like Illinois need coronavirus relief for pensions and health care"
- *Pensions & Investments:* "Commentary: The time is ripe for public pension obligation bonds"
- Center for Retirement Research: "An Update on Pension Obligation Bonds"
- GFOA: ""Pension Obligation Bond Advisory"

NASRA News Clips

April 29, 2020

In the Media

State and local government budget crisis will lead to layoffs

When states can't patch their budgets, financial firms downgrade their credit rating. That makes it more expensive for them to borrow cash, and leaves less money to rebuild once the country emerges from the public health crisis. In some states, pension funds are also under threat from the coronavirus. Illinois is seeking $10 billion from the federal government to boost its chronically underfunded pension that is among the worst in the country. Absent the help, Illinois will continue borrowing cash to cover current costs, dig itself deeper into a borrowing hole and continue on a course that may leave lawmakers in Springfield covering interest on pension loans and not much else.

Time
Employment@NASRA.org

Tweet of the Week

Studies & Reports

Moody's: Without higher taxes, returning to 2019 state revenue levels will take years

The crisis is wreaking havoc on state budget forecasts and will cause fiscal 2021 tax revenue to fall short of 2019 collections by nearly 15%. The shortfalls will be even larger compared with revenue projections made before the pandemic. It will take years for state revenue to return to 2019 levels without tax increases, while recovery to a level where no coronavirus crisis occurred is unlikely over a five-year horizon. Individual states will fare differently depending on their tax structures, dependence on volatile revenue sources, and severity of the regional coronavirus outbreak.

Sector In-Depth

Trustees reduce Social Security's long-term inflation assumption from 2.6 to 2.4 percent

According to a May 2018 report on ESG by the Governmental Accountability Office (GAO), a minority of plans in the U.S. incorporate **ESG principles** into their investment process, and the use of ESG investing is more common among pension funds in Canada and Europe.

Federal Focus

McConnell suggests state bankruptcy, Trump questions more relief for states/localities

Last week, Senate Majority Leader Mitch McConnell said states should be allowed to pursue bankruptcy to address pensions and other financial obligations and any federal assistance should not be spent on addressing pension underfunding. His statement sparked a flurry of "no bailout" articles and calls for strings to be tied to federal aid. While the President had formerly stated his support for flexible financial assistance to states, this week he is asking why the taxpayers of America should be bailing out poorly run states like Illinois. Treasury Secretary Mnuchin has also weighed in opposing bailouts.

The Hill
WSJ
P&I
Reason Foundation
Bloomberg

The state bankruptcy suggestion met a rapid demise nearly a decade ago and should again

The last time America's states were in the throes of a crippling fiscal crisis, an idea was floated to let them file for bankruptcy. It was immediately panned across the political spectrum as unconstitutional, unnecessary and harmful, and the discussion was dropped after a single hearing in the U.S. House of Representatives.

Bloomberg
Center for Budget and Policy Priorities
Washington Post
LA Times
NASRA 2011 Congressional Testimony

[The Social Security chief actuary] expects that monetary policy will continue to target relatively low inflation, but will not be able to prevent occasional bursts of inflation caused by demand and supply shocks. Accordingly, the ultimate average annual percentage change in the CPI-W is assumed to be 2.4 percent, which is 0.2 percentage point less than in the 2019 report.

The Long-Range Economic Assumptions for the 2020 Trustees Report
Cleveland Fed 10-year inflation expectations

Federal court affirms Texas Supreme Court ruling that retirees have no property right to method of payment

Retirees do not have a constitutionally protected property interest in a particular method for receiving retirement benefits, the court said, rejecting retiree LaDonna Degan's challenge to a law limiting how retirees can take their [DROP] benefits from the Dallas Police and Fire Pension System.

Law360
See the ruling

Perspectives

Slate.com: State budgets are toast

If Congress proposes aid with conditions, states will likely be in no position to turn them down. The Federal Reserve's aid is less likely to come with its own strings, except for one major one-the money will have to be paid back down the line, as it is providing loans, not grants. Over the next year, states will be dealing with a continuing public health emergency, huge new demands on public services, radically reduced revenues, insufficient federal aid, increasing debt loads, and potentially new conditions imposed by the federal government, if they even get lifesaving infusions of cash to begin with.

Read the article

Pew: How the market downturn could affect public pensions

Although recent investment shortfalls will require increased contributions to make up the losses over time, most state and local governments have already set or proposed annual contributions for the next fiscal

Social Security payments projected to exceed income in 2021, reserves depleted by 2035

The Social Security Board of Trustees released its annual report on the long-term financial status of the Social Security Trust Funds. The year when the combined trust fund reserves are projected to become depleted, if Congress does not act before then, is 2035. This is the same as last year's projection, and 79 percent of benefits payable at that time. The total annual cost of the program is projected to exceed total annual income, for the first time since 1982, in 2021 and remain higher throughout the 75-year projection period.

Press Release

year. That means this effect will not be immediate. Still, if revenues decline as expected, efforts to meet even these funding requirements-which are expected to increase by an average of 6% over current levels-would have the effect of crowding out spending for other government services as spending for health and safety net programs are likely to increase. As a result, states will have tough choices to make in terms of balancing their plans to reduce pension debt with preserving core services.

Greg Mennis

Reason Foundation: COVID-19 is absolutely wrecking public pensions

We won't know for sure how badly state pension systems got whacked by the coronavirus-induced economic crash until later in the year, but a new tool released by the Reason Foundation's pension integrity project offers a glimpse into the potential damage. Using current data from state pension plans and forecasted investment losses, the tool estimates how much more debt states could be facing by the end of the year.

Read the article
See the tool

Snapshots of This Week's FYI NCTR April 29, 2020

1. A top GOP Congressional leader thinks states should be permitted to file for bankruptcy instead of receiving Federal aid in response to the COVID-19 crisis, and public pensions are given as a reason.
2. “Never let a good crisis go to waste” is a saying that public pension critics have whole-heartedly embraced. Every week brings warnings of impending doom and calls for drastic “reforms.” However, as a recent opinion piece warns, governments and the public should learn from the mistakes made in connection with prior crises and maintain funding discipline.
3. New reports focus on teacher pension plans, with one claiming increasing unfunded pension liabilities are impacting the ability of school districts to serve students, while the other examines the extent to which states subsidize the “employer contribution” toward retirement savings. A third calls for a new approach to teacher retirement plans.

State Bankruptcy: What is Going On?

A top GOP Congressional leader thinks states should be permitted to file for bankruptcy instead of receiving Federal aid in response to the COVID-19 crisis, and public pensions are given as a reason. What is the likelihood this could happen? What are the potential consequences? And does this discussion open the door for other damaging bankruptcy-related proposals to address public pension underfunding?

On April 23, Senate Majority Leader Mitch McConnell (R-KY) said in lieu of more Federal aid, he "would certainly be in favor of allowing states to use the bankruptcy route." He said Republicans were "not interested in solving [states'] pension problems for them," and stressed, "we're not going to let them take advantage of this pandemic to solve a lot of problems that they created themselves [with] bad decisions in the past."

Will Republicans agree with him and seek to replace the $500 billion in assistance the National Governors' Association (NGA) is seeking from Congress with an amendment to the bankruptcy laws? Is such a provision Constitutional? Would it help or hurt state finances? Finally, what are the implications for pubic pensions?

The bankruptcy process is totally the prerogative of the Federal government under the Constitution. Bankruptcies are overseen in Federal court pursuant to the Federal Bankruptcy Code. Local governments do have the ability to file for bankruptcy under Chapter 9 of the Bankruptcy Code, but only if their state authorizes them to do so. However, as currently written, the law does not include provisions permitting states to declare bankruptcy.

Therefore, in order for states to be able to do so, Federal law would have to be amended. The question then becomes, is such a change permissible under the Constitution?

Some experts believe it is not. Their arguments against such a law passing muster constitutionally are two-fold:

1. Allowing states to file for bankruptcy would conflict with the 10th amendment, which provides that powers not delegated to the Federal government nor prohibited for states are reserved to the states.
2. Congress's ability to write bankruptcy laws does not preempt the Constitution's prohibition on states impairing their own obligations under contracts. Specifically, the contracts clause in Article I of the Constitution bans states from interfering with private contracts, which most bankruptcy proceedings would allow debtors to cancel or materially alter. Therefore, "there's an argument that Congress would be aiding and abetting states in passing laws to compromise contracts" if it passed a law authorizing states to file, University of Pennsylvania law professor David Skeel told *Bloomberg Law*.

Furthermore, simply extending Chapter 9 to cover states would not work either, according to Bruce Markell, a Northwestern University law professor and former U.S. bankruptcy judge. A typical municipal bankruptcy would involve the creation of a board to oversee the restructuring and this would not be an option given state sovereignty, according to Markell. Skeel agreed, saying any law allowing states to declare bankruptcy also could not include a Federal oversight board such as the one created in the 2016 Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA).

However, others think permitting states to declare bankruptcy could be constitutional if Congress avoids infringing on state sovereignty and relies on court oversight, rather than an outside board. For example, John J. Rapisardi, Chair of O'Melveny & Myers' global restructuring practice, says it would not be difficult to create a bankruptcy system for "a sovereign state essentially consenting to the jurisdiction of a specialized Federal court."

Professor Skeel also said the contracts clause problem could potentially be avoided because it only prohibits states from altering contract rights, while a new law authorizing state bankruptcy would be a Federal action, and thus not implicate the Constitutional ban.

Regardless, it seems clear any such law in this area would likely end up requiring review by the U.S. Supreme Court.

Thus, a law permitting states to declare bankruptcy, even if it could clear Congress, would likely not take effect immediately. Therefore, it would be of little help in addressing the financial challenges states are experiencing due to the coronavirus crisis. As Eric Kim, head of the state government group at Fitch Ratings, told *The Hill,* while companies file bankruptcy to address long-term liabilities, states' main issue is currently the economy and lower revenues. "Declaring bankruptcy doesn't fix the economy," he said.

David Frum went even further in *The Atlantic*, saying "McConnell's schemes for state bankruptcy are utterly irrelevant to the present crisis." Frum, a former speechwriter for President George W. Bush, pointed out reducing future pension liabilities "will not replenish lost revenues or reduce suddenly crushing social-welfare burdens."

A recent *Reuters* article says BofA Global Research also agrees allowing states to file for bankruptcy is not the way to deal with the deep financial problems governments are facing from the COVID-19 economic disaster. More significantly, the article warns such action "would knock down the municipal bond market."

In a research report, BofA said the $3.8 trillion muni market would "certainly sell off" if the idea gathered support. "It will be highly disruptive to the municipal bond market broadly and will result in significantly higher borrowing rates at a time when those costs are least absorbable," the BofA report said. The research report also pointed out states would not likely choose to file for bankruptcy for fear of hurting their market access.

Josh Barro, writing in *New York Intelligencer*, is also concerned with the impact on the municipal bond market, stressing the Federal Reserve is already intervening throughout the credit markets to soothe risk fears and ensure the continued availability of credit. “All a state bankruptcy option would do is make the Fed’s job of smoothing out the debt markets even harder,” he says.

So how likely is it that McConnell will push state bankruptcy in lieu of Federal aid to state and local governments? After all, his suggestion immediately drew harsh rebukes from Democrats both on and off Capitol Hill. Even some Republicans raised strong objections, including Maryland Governor Larry Hogan (R), Chairman of the NGA, who said McConnell “probably would regret” making the comment.

Congressman Peter King (R-NY) was more direct in his objections, saying McConnell’s “dismissive remark that States devastated by Coronavirus should go bankrupt rather than get the Federal assistance they need and deserve is shameful and indefensible.” "To say that it is 'free money' to provide funds for cops, firefighters and healthcare workers makes McConnell the Marie Antoinette of the Senate," King tweeted.

Nevertheless, it should be remembered state bankruptcy is not “some passing fancy” of Senator McConnell. As David Frum noted, Republicans have been advancing the idea for more than a decade. For example, Jeb Bush and Newt Gingrich published a joint op-ed advocating state bankruptcy as a solution for the state of California in 2011. The “Tea Party Congress,” elected in 2010, also explored the idea of state bankruptcy, and Gingrich promoted it in his run for the 2012 Republican presidential nomination.

Also, President Trump on Monday asked why “poorly run states” -- which he claimed are all “Democrat run and managed” -- are seeking aid from the Federal government in the middle of the coronavirus crisis “when most of the other states are not looking for bailout help?” *Fox News* said it was “seemingly piggy-backing off Senate Majority Leader Mitch McConnell’s suggestion that they instead file for bankruptcy.”

It may well be McConnell is simply trying to position himself for the next piece of coronavirus legislation, which Democrats and even some Republicans think should contain funding for the states along the lines – if not also in the amount – being requested by the NGA. After all, extreme demands followed up by small, slow concessions is a tried-and-true tactic of hardball negotiations.

McConnell may also be maneuvering to obtain some kinds of “strings” on Federal aid that would prohibit the funds from being used in connection with pension liabilities, as has been suggested by many public pension critics. Settling for these as small concessions, in return for dropping the extreme of state bankruptcy, is not unthinkable, and could possibly make it easier for some Republicans to accept Federal aid as part of a future relief package.

Indeed, yesterday, April 27, *Politico* reported McConnell “is cracking the door to an agreement with congressional Democrats after taking a hard line with his recent suggestion that states go ‘the bankruptcy route.’” He said it is “highly likely” the next coronavirus response bill will aid state and local governments. However, there will be strings attached.

In the interview, McConnell said he wants Congress to limit the liabilities of health care workers, business owners and employees from lawsuits as they reopen in the coming weeks and months. However, while he did not mention public pensions this time, he did once again underscore that he was not in favor of “writing a check to send down to states to allow them to, in effect, finance mistakes they’ve made unrelated to the coronavirus.”

So, public pensions may not be out of the woods yet.

In any case, the discussion of state bankruptcy is particularly worrisome given the ever-increasing number of claims by opponents of the public pension defined benefit (DB) model that state spending on essential public services is already being severely constrained by payments to reduce unfunded pension liabilities. They insist these public services will be all the more underfunded due to the dire financial situation caused by the pandemic and will feel the pension burdens even more.

This “crowding out” argument has already produced a specific proposal developed by Diana Furchtgott-Roth, a senior fellow at the Manhattan Institute. In 2016, she wrote a paper in which she proposed Congress amend the Bankruptcy Code to provide states with the authority to override any public pension protections if a state makes a formal finding that its pension funding obligations damage the performance of “essential” state services.

Technically, her proposal would not allow states to file for bankruptcy. Instead, it would create a new section of the Bankruptcy Code authorizing a “Proceeding to Protect Essential State Actions.” It would provide that, notwithstanding any prohibition against or limitations on changes to pension benefits, such as those contained in a state’s constitution or in statute, law, regulation, or judicial decision, they could nevertheless be modified if such changes were made in order to ensure the performance of essential state actions.

Furthermore, any such changes could be prospective, retrospective, or both, and could include modifying the vesting or qualification requirements, or actually reducing pension benefits.

Ms. Furchtgott-Roth argues that there would be no infringement on states’ rights, as states’ governors and legislatures would simply be given “the option to use the new federal law to enact state solutions in the same manner in which they enact other bills,” but not be required to do so. Thus, states would retain their sovereign powers since only they themselves would be able to approve any plan to reduce pension debt. Also, she notes that state bondholders and other creditors would not be harmed, as the new proceeding “only gives state legislatures and governors an option to reform their public pension systems,” not to file for bankruptcy.

So, there is danger ahead. If the Senate seriously considers state bankruptcy legislation, expect to see this proposal resurrected.

- *Bloomberg Law:* “State Bankruptcies May Be Legal If System Structured Correctly”

- *The Hill*: "McConnell State Bankruptcy Remarks Raise Constitutional Questions"
- *The Atlantic*: "Why Mitch McConnell Wants States to Go Bankrupt"
- *Reuters:* "U.S. State Bankruptcy Push Would Disrupt Municipal Bond Market: BofA"
- *New York Intelligencer*: "Why Mitch McConnell's State Bankruptcy Idea Is So Stupid"
- *Politico: "McConnell Dangles Aid to States — With a Catch"*
- Manhattan Institute: "Empowering Illinois' Pension Reform" (See page 20 for legislative language)

A Response to Critics of Public Pensions During the Pandemic

"Never let a good crisis go to waste" is a saying that public pension critics have whole-heartedly embraced. Every week brings warnings of impending doom and calls for drastic "reforms." However, as a recent opinion piece warns, governments and the public should learn from the mistakes made in connection with prior crises and maintain funding discipline.

A new commentary from Director of the Public Sector Retirement Systems Project for the Pew Charitable Trusts, Greg Mennis, says overall state pension debt, currently estimated by Pew to be $1.2 trillion, could increase by half a trillion dollars, absent positive returns in the next three months, "reaching an all-time high." The Mennis piece, dated April 23, says that as "a result of the stock market's recent decline and economic conditions more generally," most public pension funds "are on pace for their first fiscal year loss since 2009," meaning, in the aggregate, "they are currently short of annual return targets by 10 to 15 percent."

[As an aside, note Mennis' observation "State contributions are the largest source of funds used to make benefit payments to retirees," and that this means "any reductions or delays may require plans to sell additional assets to meet payment requirements," which could "necessitate additional rebalancing of portfolio funds to align with asset allocation targets, which could then hinder their ability to meet performance goals." This is oddly worded. Investment earnings account for the majority of public pension revenue. Furthermore, as well-respected public pension experts point out, many sponsors always pay their full required contribution, so it could also be misleading to speculate on the effects of all employers shorting their pension contributions, when it may only affect a subset of plans. Finally, they also note claiming that a change in expected contributions received could disrupt the rebalancing process, which could affect returns, is also a concern that may not affect many plans or may not materially affect others.]

Charles Lehman, a staff writer for the *Washington Free Beacon*, is quick to lay the blame for the funding shortfall on public plan ineptitude, writing "the pension shortfalls are not just a product of the bear market," but, according to "experts," are in part "covering for more than a decade of economic mismanagement." This has been as the result of chasing "increasingly risky investments to fund generous benefits," which have allowed them to "dodge hard questions about the viability of excessively generous public pensions," Lehman insists.

Andrew Biggs, a senior fellow at the American Enterprise Institute (AEI), essentially agrees, telling Lehman "there's been kind of willful ignorance among a lot of [public pensions] about what's involved in really running one of these things." Lehman also reports Josh McGee tells him states "largely failed to capitalize on the market expansion between 2009 and 2020." McGee, formerly with the Laura and John Arnold Foundation, is now, among other things, associate director of the Office for Education Policy in the Department of Education Reform at the University of Arkansas and a director of Equable (featured in the following "NCTR FYI" story).

[Regarding McGee's comments, NCTR would note public pensions doubled their asset values as of the fourth quarter of 2019 from where they stood after the Great Recession, and did so while also distributing approximately $2.45 trillion in benefits from FY 2009 through FY 2018, according to Keith Brainard, research director for the National Association of State Retirement Administrators.]

According to Lehman, both McGee and Biggs told him "they could get behind Federal support for pension funds, but only if there were safeguards in place: some reduction in or freeze on benefit increases, restrictions on the risk level of assets bought with federal funds, and requirements for additional reporting." Indeed, Biggs wrote in the *Wall Street Journal* this weekend that any state "looking for a pension handout must either live by the stricter accounting rules federal law imposes on private pension plans or freeze its pension and shift all employees to defined-contribution retirement plans."

The reference to the accounting rules, which has been a particular focus of Republicans in their criticism of multiemployer union plans who are desperately in need of financial relief, is concerning. These Taft-Hartley plans use accounting rules similar to public pensions when determining unfunded liabilities. There have been GOP efforts made in the past to potentially include language in any multiemployer plan solution purportedly designed to guard against future Federal bailouts of governmental pension plans, as well as potentially addressing the discount rates used by public plans.

This plea by Biggs will not fall on deaf ears, particularly if, as many Democrats desire, the next coronavirus legislation includes a multiemployer plans "fix."

To help bolster the idea public plans are teetering on the precipice and present an opportunity to wrest commitments to "reform" their pension plans from states desperate to obtain much-needed Federal aid, the Reason Foundation is also offering a "tool" to help the public see how public pensions' unfunded liabilities and funded ratios "are being impacted by the market and economic downturn."

The Reason Foundation has received over a million dollars in grants over the years from the Laura and John Arnold Foundation (now part of Arnold Ventures). It believes that pension reform "should follow the clear and undeniable trend in the private sector and convert employees from DB plans to self-directed, 401(k)-style DC plans as much as possible."

The Reason Foundation acknowledges although "the long-term effects of the pandemic and economic downturn are unclear," nevertheless, "initial estimates from the Pension Integrity Project at Reason Foundation suggest that public pension plans could see their unfunded liabilities skyrocket to between $1.5 trillion and $2 trillion if the latest returns fall between 0 percent and -15 percent for the current fiscal year."

Their new "tool" allows an individual to "choose your preferred state public pension plans and investment return rate to see how their unfunded liabilities and funded ratios are being impacted by the market and economic downturn." Try it out to see how accurate you think their results prove to be for your plan and be prepared to explain why to stakeholders who may have used it.

After all, don't forget, "The Pension Integrity Project at Reason Foundation offers pro-bono consulting to public officials and other stakeholders to help them design and implement pension reforms that improve plan solvency and promote retirement security," as they underscore in connection with this tool.

In the meantime, other public pension critics have focused on municipal bonds. For example, Robert C. Pozen, a senior lecturer at MIT Sloan School of Management and former president of Fidelity Investments, says he is concerned the Treasury and the Federal Reserve have interpreted their mandate under the recent coronavirus relief legislation to include a broad range of short-term lending facilities open to local governments. In an opinion piece in *MarketWatch* entitled "The Fed Should Not Be Bailing Out the Underfunded Pensions of Cities and States," he warns it would "be a mistake for these two federal agencies to extend their current mandate to buying long-term municipal bonds from local governments with severely underfunded pension plans."

Pozen concludes if Congress decides to support any kind of Federal bailout of pension plans, it should expressly link "the receipt of Federal funds to implementation of pension reforms — instead of obscuring federal assistance in a complex lending program of the Federal Reserve."

Fortunately, however, not everyone is piling on. In a recent op-ed in *Chief Investment Officer*, Charles E.F. Millard acknowledges as some lawmakers suggest states consider declaring bankruptcy, "governments will be tempted to cut back on pension contributions." However, he strongly urges them not to do so.

Millard, a senior adviser for Amundi Pioneer Asset Management and the former director of the U.S. Pension Benefit Guaranty Corporation (PBGC), reminds readers "whatever happens with bankruptcy proposals, public pensions will still have to be paid, and state and municipal governments should continue making their pension contributions."

As he notes, "[w]hen the dust begins to settle after the current market turmoil, public pensions' funded status will come into view," and in some cases, "it will likely be quite disturbing."

"Surely there will be criticisms by political leaders and policymakers," he continues. They will ask "[w]hy wasn't the investment staff more conservative? Didn't they know a crash was coming? Weren't we supposed to rebalance? How did we get so heavily weighted to equities? Why do we have so much in the stock market anyway? This is for retirees—shouldn't it be safe?"

However, Millard underscores "the real problem in U.S. public pension underfunding is not related to investments." Indeed, he points out as long-term investors, "pensions have actually done pretty well."

"The real problem in public pension underfunding is the failure of governments—the plan sponsors—to make the necessary contributions to the pension plan in the first place," Millard stresses. "Going forward, pension funding status will depend as much on state and local governments meeting funding obligations as it will on investment performance," he underscores.

Millard then discusses how underfunding is not caused by investment performance, citing the experiences of the 2001-2003 "dot-com bubble" and then the 2008-2009 financial crisis. In the years following these crises, he notes investment performance was relatively strong. For example, after the dot-com bubble burst, the average public pension investment return for fiscal years 2003-2005 was 11.5 percent. Public plans averaged 11.3 percent in the three years that followed the global financial crisis.

However, as he also points out, in the years following these crises, state and local governments unfortunately "pulled back significantly on pension funding at the worst time." "That is the danger they must avoid today," Millard warns.

Specifically, he explains how in the years after the markets fell, many states and cities fell short on pension contributions, "and pensions' funded status has not recovered." For example, he calculates the total value of those missing contributions for 2003 through 2006 was $27.7 billion, "money that could have been growing in those plans all this time," he points out. The shortfall in the four years following the global financial crisis was worse, he estimates, totaling $68.5 billion.

Millard also believes that in addition to making their full contributions to their plans, sponsors must choose shorter time horizons to amortize liabilities; they should never roll their amortization periods into new ones; and they must never allow negative amortization.

He concludes by observing one of the arguments in favor of the current federal rescue legislation is that "the companies are not at fault and that this is a crisis."

Millard says “[s]imilarly, the workers are not at fault and the public pension system in some states is in crisis.”

Therefore, Millard warns, “even though it will surely be difficult to do so, states and cities must make the proper contributions and not let their funding practices put their pensions in further peril.”

Amen!

- Pew Charitable Trusts: “How the Market Downturn Could Affect Public Pension Funds”
- *Washington Free Beacon:* “States Made Risky Bets with Pensions Before Coronavirus. Now They Want a Bailout”
- The Reason Foundation: “Previewing the COVID-19 Impact on State Pension Plans”
- *MarketWatch:* “The Fed Should Not Be Bailing Out the Underfunded Pensions of Cities and States”
- *Chief Investment Officer:* “Op-Ed: U.S. Public Pension Underfunding—Don’t Make the Same Mistake Thrice”

New Reports Examine Teacher Pensions

New reports focus on teacher pension plans, with one claiming increasing unfunded pension liabilities are impacting the ability of school districts to serve students, while the other examines the extent to which states subsidize the “employer contribution” toward retirement savings. A third calls for a new approach to teacher retirement plans.

The first report, prepared by Equable, is entitled “Hidden Education Funding Cuts: How Growing Teacher Pension Debt Is Eating into K–12 Education Budgets.” Within the report, it is claimed that “less education money is available today for teacher salaries and classroom spending than there would be if teacher pension funds had been better managed over the past two decades.”

Equable describes itself as a bipartisan nonprofit, focusing on cities and states “whose unfunded retirement promises to threaten the stability of their government’s finances and the future of their employees. Which is to say, almost all of them.”

Equable’s executive director is Anthony Randazzo, formerly managing director of the Pension Integrity Project and director of economic research at the Reason Foundation. Its directors include Josh McGee, former executive vice president at the Laura and John Arnold Foundation. Other directors, past and present, include Dan Liljenquist, former Utah state senator who authored that state’s major pension reforms

The new Equable report actually consists of a national report, as well as individual reports for each state. It examines changes in education funding and teacher pension costs for all 50 states and Washington, D.C., between 2001 and 2018. Equable said it used information reported to the National Association of State Budget Officers (NASBO) to calculate states' K-12 spending and used funding data reported by the statewide retirement systems covering classroom teachers to calculate a state's pension spending.

The national report says school districts nationwide are struggling financially for a range of reasons, but "growing pension costs are exacerbating that existing fiscal stress." It claims the share of education spending going to pay pension costs has nearly doubled from 7.5 percent in 2001 to 14.4 percent in 2018. "That means even as state governments have added money to education budgets, pension costs have grown faster," the report asserts, calling this "the hidden cut to education funding."

Equable says the effects "are felt particularly hard in high-need districts which have fewer local resources to draw on to fill in the gaps when education costs rise, creating less funding for teacher salaries and programs aimed at improving academic and other outcomes.

However, the problem, according to Equable, is not that teachers' retirement benefits are too generous or costly. "Rising pension costs are not necessarily an inherent problem with pension plans themselves but are the result of fiscal challenges associated with paying off hundreds of billions in pension debt," the report claims.

Indeed, in 2018, K–12 employers paid $19.6 billion in normal costs and $42.4 billion more to cover unfunded liability amortization payments. "In 2001, money paid toward unfunded liabilities was virtually zero," the report asserts.

The report argues required contributions to teacher pension funds could be paid directly by the state out of legislatively managed funds, or they could be paid by a local employer such as a school district. And while some states use both methods for different portions of pension costs, the report says the money used almost always comes from funds intended to be spent on education.

Very few states use general fund dollars for teacher pension costs, according to the report, and, "[i]n practice, this budgeting approach can pit the interests of student programs and teacher salaries against teacher pension funding.

However, the report argues "it doesn't have to be this way." Instead, it suggests education budgets "could be automatically expanded as teacher pension costs grow, or teacher pension debt costs could be paid out of general funds."

The report says "[s]imply being a 'well-funded' pension system does not mean that pension costs aren't cutting into school budgets." Furthermore, at the district level, "the specific consequences of this growing crowd out are taking shape in the form of increased class sizes, fewer teacher pay increases, and elimination of enrichment programs like art, music, and sports," according to the report.

Equable argues that, to solve this challenge, “it is important to recognize that teacher pensions are not inherently the problem.” “The real culprit in this story is pension debt — the unfunded liabilities and their costs — that has been allowed to accumulate over years of neglect by lawmakers, administrators, and other policymakers,” the report argues. The report warns that without any action, the problem is likely to only grow worse, as pension costs increasingly cut into education budgets.

Beware of wolves in sheep’s clothing.

The second report is a brief prepared by University of Arkansas Professor Robert Costrell, also long a critic of public teacher pensions. His work examines state subsidies of school district pension costs, and claims in 2018, this exceeded $19 billion across 23 states. “To put that amount into perspective, 2018 federal spending on Title I programs was $15.8 billion,” the abstract of his study underscores. Costrell’s brief says this revenue stream is often ignored in analyses of state aid for K–12 and its distribution across districts.

Costrell claims this subsidy can be as much as $2,400 per pupil, as it is in Connecticut. In Illinois, it comprises an additional 56 percent of state spending on K–12 on top of all formula and categorical aid. His brief also says an “unintended consequence” of this method is larger subsidies go to low-poverty districts that can afford to pay higher teacher salaries, running “completely counter to the progressive purpose” of state funding formulas meant to shift more education funding toward schools and students with the greatest needs.

The third new item is from the Reason Foundation’s principal of Retirement Policy Consulting and senior fellow Richard Hiller. In the piece, Hiller argues today's K-12 education workforce is more mobile than ever and requires a new approach to public retirement plans.

Hiller looks to higher education for his model. His focus is on educational employment tenure today and teacher shortages.

He starts by noting the median tenure of private sector educational services workers was 4.2 years in 2018, according to the U.S. Bureau of Labor Statistics. He then observes State government employees (including public school teachers, public safety and other state government workers) median employment tenure in 2018 was “just slightly higher” at 5.9 years.

On this basis, he insists this “belies the notion that people seek public sector work for permanent, lifetime employment anymore these days, as was assumed in the past.”

However, this ignores the fact that a career in teaching is much different than that for public safety and other state government workers, with which he acknowledges teachers are combined for his comparison. Finally, 5.9 years is not “just slightly higher” than 4.2 years; it is actually about 40 percent higher.

In short, this should prepare you for the quality of the rest of his analysis, which purports to find, among other things, the following:

- Today, the K-12 teacher market is a mobile one and several stops along a teaching career should be expected.
- The teaching profession is consistent with private sector employment today; in 2018 median tenure in all private-sector positions was 3.8 years. The short median tenure in current positions by teachers today means teaching is a mobile profession.
- Evidence of the inability of traditional teacher pension plans to help in attracting qualified teaching candidates is seen in the widespread teacher shortages across the country.
- The back-loaded teacher defined benefit model compounds the teacher shortage problem because "a young teacher who knows that they do not want to stay in his or her current position indefinitely may also understand that the traditional pension plan will not provide much of a benefit at retirement if they leave after only a few years. Given that understanding, the teacher knows it is best to leave sooner to have a better chance of attaining a new career path or position in which they could stay for an extended part of their professional life."

Clearly, Hiller is not familiar with the research by Nari Rhee, the Director of the Retirement Security Program at the University of California Berkeley Labor Center, that finds while approximately 40 percent of new teachers are likely to leave within the first five years of teaching, "the vast majority of the teaching profession" consists of teachers who make teaching a career.

Hiller has also not apparently looked at the recent National Institute on Retirement Security (NIRS) issue brief which finds that millennials working in state and local government are satisfied with their jobs and intend to stay with their employers so long as their benefits are not cut.

Specifically, NIRS found:

- Despite knowing they could earn a higher salary in the private sector, millennials working in state and local government are satisfied with their jobs and total compensation.
- State & local government millennial employees are planning to stick with their current job, but a change in benefits might push some out the door.
- Millennials working in state and local government are highly supportive of pensions, and they see the advantages of their benefits beyond retirement.
- State and local government millennial workers say eliminating pensions has negative consequences.

Two-thirds of Michigan state employees face furloughs; California state workers face pay cuts

Gov. Gretchen Whitmer announced that the state will participate in a federal "work share" program, allowing employees to work fewer hours but collect partial unemployment benefits to make up a portion of their lost wages. The furloughs - two layoff days per two-week pay period for non-managers - will start this Sunday and go through July 25. Higher-level managers will not be part of the work share program but will take one layoff day every other pay period - a 5% pay cut. ... Gov. Gavin Newsom last week proposed reducing state workers' pay by 10 percent to help address a projected budget deficit of $54 billion.

Detroit Free Press
Sacramento Bee
Employment@NASRA.org

City of Flagstaff, Arizona will eliminate pension debt by borrowing funds using city facilities as collateral

Instead of borrowing the money using a traditional bonding mechanism, Tadder told the council the city could then use what is called a certificate of participation. In such an agreement, the city uses facilities to back the loan, similar to a mortgage on a house. The city would still retain ownership of the facilities but would then reroute the money the city is currently paying into the pension debt to pay off the new debt. If the city defaulted on the loans, ownership of the facilities would transfer to the investors.

Arizona Daily Sun
Credit Effects@NASRA.org

Oklahoma police retirement system staff returns to the office this week

"The legislature went back into session [last week], and so long as they feel that they can go back to work, then I feel as a state agency we should follow," said Ginger Sigler, executive director at OPPRS. Returning to the office is not mandatory, Sigler said, and the pension plan will work with any employees who wish to continue working from home.

AI-CIO

NASRA publishes overview of public retirement system governance stakeholder roles

Public retirement system governance is dispersed among different stakeholders-chiefly, the legislature, the chief executive, and the retirement system board-to prevent one group from accumulating excessive authority in one area. Public retirement system governance stakeholders play certain roles in the oversight and administration of retirement benefits for employees of state and local government, and within their unique responsibilities each stakeholder faces restrictions and limitations on their activities.

Public Retirement System Governance@NASRA.org

Moody's: Pension risks among Illinois state and local pensions are bigger now than during the Great Recession

The Illinois Supreme Court has ruled that the state constitution protects both past and future pension benefit accruals by active employees. Less generous benefit "tiers" for more recent hires have significantly lowered the cost of current benefit accruals, but will take years to materially lower benefit outflows. Should state law be changed to enable Illinois or its local governments with severely underfunded retirement systems to gain budget relief by reducing contributions, such moves could significantly constrain pension asset accumulation and, in the most severe cases, risk pushing retirement systems into insolvency.

Sector In-Depth

Federal Focus

Bipartisan legislation would provide states and cities billions, but may not be deposited in state pension funds

Debates over whether to authorize additional federal aid to state and local governments continue to be met with protests that such funds would be used to address public pension underfunding rather than for immediate revenue and expenditure issues caused by COVID-19. The bipartisan State and Municipal Assistance for Recovery and Transition (SMART) Act provides $500 billion in flexible state and local

Tweet of the Week

The **Public Fund Survey** is an online compendium of key characteristics of most of the nation's largest public retirement systems. Beginning with fiscal year 2001, the Survey contains data on public retirement systems that provide pension and other benefits for 12.9 million active (working) members and 9.6 million annuitants (those receiving a regular benefit, including retirees, disabilitants and surviving beneficiaries). At the end of fiscal year 2018, systems in the Survey held combined assets of $3.62 trillion.

New Mexico governor signs bill creating secure choice retirement plan

Under the legislation, privately employed and self-employed workers who don't have employer-based retirement accounts may be provided the ability to contribute into Roth individual retirement accounts (IRAs) in a savings program overseen by a state-appointed board. The law also establishes an online marketplace from which employers that want to offer their own plan can find and compare low-cost retirement savings options.

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Perspectives

Give teachers non-pensionable pay raises to protect pension plans

If such a policy had been in place when the last recession began to hit budgets, the California State Teachers Retirement System would have saved 11%-$1.35 billion-on its liabilities between 2008 and 2010 alone. Illinois' Teachers Retirement System would have saved 18%-$438 million-over two years. That savings translates to lower pension bills for districts, which would have freed up more money at a time when it was desperately needed.

Marguerite Roza in Forbes

government aid to help cover rising costs to combat COVID-19 and lost revenues due to the economic fallout, stipulating that the new funds cannot be deposited into a state pension fund.

Tax Foundation
McClatchy DC
Press release and bill text

US senator and representative from Florida ask state retirement board to "reconsider" investments in China

"It is of great concern to us that Florida public employees are often unwittingly investing in funds that hold stock of Chinese companies with direct affiliation to the CCP and the PLA, and we anticipate that it will be to all Floridians. Increased scrutiny for Chinese securities falls right in line with SBA's current management of the FRS. The FRS currently has a number of legally required and laudable global governance mandates, including prohibitions on investing in companies that do business with Cuba, support the Maduro regime in Venezuela, or boycott our ally Israel."

Press release
Read the letter

Continued federal interest in limiting global investments that include China

By ordering the main US federal government pension fund to shun Chinese stocks, the Administration has opened a new front in America's wide-ranging confrontation with China that risks fragmenting global capital markets. Some federal lawmakers are interested in going further, including a ban on Chinese firms from listing on US stock exchanges and/or requiring Chinese firms to abide by federal auditing rules and disclosure requirements. Senator Rick Scott (R-FL) recently sent a letter to US stock exchanges, major pension plans and underwriters urging them to review their policies and discontinue coordination with US-listed Chinese-based companies.

Asia Times
Florida Daily

Snapshots of This Week's FYI NCTR May 20, 2020

1. The next COVID-19 legislation has begun moving through Congress, but at a much slower and unsure pace than previous relief efforts.

2. New bipartisan state and local government funding legislation just introduced would deny use of any Federal aid in connection with public pensions.
3. All things dealing with the COVID-19 crisis have deservedly been in the spotlight and the pandemic is the focus of virtually everyone's attention. But life goes on otherwise, and important victories should still be celebrated. One such victory took place in Tennessee earlier this month, helping ensure public education funds are used exclusively to maintain, support and strengthen public schools.

New COVID-19 Legislation and Public Plans

The next COVID-19 legislation has begun moving through Congress, but at a much slower and unsure pace than previous relief efforts. The massive bill presents several opportunities to impose Federal restrictions on public plans. To learn more about these potential threats, be sure to register for today's webinar [begins at 3 PM/ET] as Leigh Snell, NCTR's Director of Federal Relations, and NCTR's Legislative Committee Chair, Peggy Boykin, Executive Director of the South Carolina Public Employee Benefit Authority (PEBA) have an insightful discussion on this topic.

The House of Representatives passed its latest response to the coronavirus pandemic on Friday, May 15. Nineteen Democrats voted against the bill, and only one Republican voted for it, signaling that unlike previous bipartisan efforts to address the crisis, this one will have a much more difficult path to becoming law – if that is even possible.

The massive $3 trillion stimulus bill, H.R. 6800, is 1,800 pages long, and is referred to by its acronym, the HEROES Act. It provides almost $1 trillion in aid to state and local governments. Other provisions include additional funding for Coronavirus testing; extended unemployment benefits; $200 billion to provide hazard pay for essential workers; a second round of stimulus payments of $1,200 per family member; more than $100 billion in additional stimulus funding for education; and up to $10,000 in student loan forgiveness for each borrower.

The bill also contains a number of retirement provisions in a section (unfortunately) referred to as the "Emergency Pension Plan Relief Act of 2020." These include clarifications to the retirement provisions enacted under the CARES Act; additional relief for single-employer private pension plans; and an effort to resolve the financial challenges faced by multiemployer union pension plans.

Specifically:

- **Required Minimum Distributions (RMDs).** RMDs are waived for defined contribution (DC) plans and IRAs for 2019. (The CARES Act waived RMDs for 2020.) RMDs made for 2019 and 2020 would also be permitted to be rolled back to a plan or IRA without regard to the 60-day requirement if the rollover is made by Nov. 30, 2020. The bill also waives the once per-year limitation for these 2019 and 2020 rollovers if rolled back within the specified time frame.

- **CARES Act Clarifications. T**he CARES Act permits eligible retirement plans to rely on an employee's certification that the employee qualifies to receive a Coronavirus-related distribution. H.R. 6800 provides a statutory clarification permitting plans to also rely on an employee's certification for purposes of the special loan rules. Also, the amendments would clarify the CARES Act's early distribution and loan relief provisions for retirement plans during the coronavirus relief period apply to money purchase pension plans (MPPP).
- **Single-Employer Defined Benefit (DB) Plan Relief.** For private sector DB plans, effective for plan years beginning after Dec. 31, 2019, all shortfall amortization bases for all plan years beginning before Jan. 1, 2020 (and all shortfall amortization installments determined with respect to such bases) would be reduced to zero, and all shortfalls would be amortized over 15 years, rather than seven years. In connection with smoothing, the 10 percent interest rate corridor would be reduced to 5 percent, and the phase-out of the 5 percent corridor would be delayed until 2026.
- **Multiemployer (Taft-Hartley) Plan Relief**. A special partition program would expand the existing authority of the Pension Benefit Guarantee Corporation (PBGC) to partition certain troubled multiemployer pension plans, which permits the agency to take the financial responsibility of some of the benefits of an eligible plan, providing financial assistance to keep them solvent for 30 years with no benefit cuts, and would also increase the number of eligible plans.

With regard to threats to public pensions, these are likely to appear when the Senate begins work on its version of a companion measure, which is not expected to happen until June. Senate Majority Leader Mitch McConnell (R-KY) has made it clear he wants to see such a package include COVID-related liability reforms extending protection from lawsuits to healthcare providers, small businesses, universities, and nonprofit organizations.

As for aid to state and local governments, McConnell has also made it clear he is not in favor of "writing a check to send down to states to allow them to, in effect, finance mistakes they've made unrelated to the coronavirus." But increasing pressure from his GOP colleagues makes it likely there will be some assistance provided in any final measure.

But what it will look like remains the problem. For example, Kevin Williamson with the *National Review* was quick to point out $915 billion of the House-passed bill's $1 trillion in aid to state and local governments is in the form of "unrestricted cash." "This will be a great boon to states and cities (largely but not exclusively Democratic) that have hamstrung themselves financially by promising government workers fat pensions and retirement benefits without actually spending the money necessary to fund those programs," he charges.

The name of the section of the House bill containing its retirement provisions – the "Emergency Pension Plan Relief Act" – only serves to underscore such perceptions among the general public and even some Members of Congress.

It should be no surprise, then, there are already efforts to restrict the use of Federal aid in connection with public pensions. For example, while Senators Dan Sullivan (R-AK) and John Kennedy (R-LA) are supporting giving states greater flexibility to spend Federal funds already provided under previous Federal COVID packages to cover general revenue shortfalls, and not just coronavirus spending, Kennedy would attach strings. Specifically, he would provide "[n]o State may use funds made available under this Act or an amendment made by this Act for any State pension fund.''

Furthermore, this effort is not solely a partisan one. For example, a bipartisan measure was introduced on Monday, May 18, by Senators Bob Menendez (D-NJ) and Bill Cassidy (R-LA) that would provide $500 billion in "flexible" funding to state, local, and tribal governments to help cover rising costs to combat COVID-19 and lost revenues due to the economic fallout. The State and Municipal Assistance for Recovery and Transition (SMART) Act is cosponsored by Senators Joe Manchin (D-WV), Cindy Hyde-Smith (R-MS), Cory Booker (D-NJ) and Susan Collins (R-ME). A bipartisan House companion bill is also being introduced.

The SMART Act, discussed further in the following FYI article, provides no state may use funds any funds made available by the new law "for deposit into any State pension fund."

We are likely to see more of these efforts, in the form of either restrictions on the use of Federal dollars in connection with public pensions, or worse yet – as some public pension critics have urged – conditioning eligibility for such funds on specific pension "reforms." These would include "freezing" current pension systems and switching all employees to DC plans, as Andrew Biggs with the American Enterprise institute (AEI) has suggested; "reforming" cost-of-living provisions; and increasing retirement ages.

Another likely area of concern relates to the provisions addressing the multiemployer plan financial crisis. There have already been numerous efforts during the last several years to lay the groundwork for adding a provision to any "fix" that would reflect the reporting mandates of the Public Employee Pension Transparency Act (PEPTA). PEPTA would also prohibit any Federal "bailout" of public pension funds – a possibility unfortunately now on the table thanks to a recent request for such from the Illinois states senate president.

Republicans have also wanted to impose private sector plan "market-value-of-liabilities" accounting rules on multiemployer plans, who currently use the assumed rate of return approach for measuring liabilities similar to that followed by public plans. Now, AEI's Biggs has also written in the *Wall Street Journal* that states should also be required to "live by the stricter accounting rules federal law imposes on private pension plans."

There has already been intense deal-making concerning the multiemployer plan provisions. As an apparent indication of the need to try to attract GOP support, the latest version in the HEROES Act would allow for new composite plans that combine DB and DC features. These would permit freezing benefit accruals in the original plan and sharing more investment risk with plan participants.

Karen Friedman, executive vice president and policy director for the Pension Rights Center said this "makes no sense to us." The provisions undermine the multiemployer system, she said. In any case, the addition of the language reflects what appears to be a willingness to accept what might have been unthinkable under other circumstances. Public pensions should not expect to be exempt from such pressures.

For now, there appears to be little room for compromise between the House, the Senate, and the Administration on this next coronavirus relief package. For example, McConnell called the House bill a "seasonal catalog of left-wing oddities," and the White House has pledged to veto the House package. The Office of Management and Budget (OMB) said it was more about "longstanding partisan and ideological wishlists than with enhancing the ability of our nation to deal with the public health and economic challenges we face."

Eventually, it is likely another relief bill will be approved. Whether it includes provisions problematic to public pensions remains to be seen, but efforts to include them are likely. NCTR will remain alert and keep our membership informed of any new developments.

Meanwhile, McConnell's proposal to permit states to file for bankruptcy may appear to be lying dormant, but there are still those interested in pursuing that course of action. Or, in the alternative, using the bankruptcy code as a vehicle to permit states to void their own state law protections against diminishing promised retirement benefits.

Finally, the Board of the Federal Thrift Savings Plan (TSP), under pressure from the Trump Administration, has postponed its planned switch of the benchmark for its international stock fund to an index representing 99 percent of world equities, including China. This interest on the part of the Administration and some in Congress does not only extend to federal pension plans and raises yet another area of potential concern for public plans.

For example, as previously reported, the Trump Administration is "looking at" CalPERS' investments in China because of concerns the investments might conflict with U.S. national security interests, according to National Security Advisor Robert O'Brien. Also, Senator Rick Scott (R-FL) has recently written to a number of public pension plans, along with stock exchanges and underwriters, asking them how they "can continue to feel comfortable selling, purchasing, or underwriting [China} securities when the risk to U.S. investors is so clear and present." Scott has urged them "to review your policies and discontinue selling, purchasing, or underwriting

U.S. listed Chinese-based companies' stock for the protection of your investors and American capital markets."

What does all this action portend for public fund investments in this regard?

For answers to this and other questions related to Federal actions with implications for public pensions, be sure to **register now** for NCTR's Federal Legislative Update this afternoon, May 20, at 3 PM/ET.

- *Pensions & Investments*: "House relief act comes with multiemployer changes – and controversy"
- National Association of Plan Advisors: "(Another) Massive Stimulus Bill Includes (More) RMD Relief, PPP Clarity & More"
- *National Review:* "No HEROES"
- Senator Rick Scott (R-FL) Letter to Public Pension Plans on China Investments

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Bipartisan COVID Relief Legislation for State and Local Governments Would Prohibit Federal Aid for Public Pensions

New bipartisan state and local government funding legislation just introduced would deny use of any Federal aid in connection with public pensions. The legislation has the support of a number of national governmental organizations.

On Monday, May 18, Senators Bob Menendez (D-NJ) and Bill Cassidy (R-LA) introduced legislation that would provide $500 billion in "flexible" funding to state, local, and tribal governments to help cover rising costs to combat COVID-19 and lost revenues due to the economic fallout. It would also, however, provide no state may use any funds made available by the new law "for deposit into any State pension fund."

The "State and Municipal Assistance for Recovery and Transition (SMART) Act" is cosponsored by Senators Joe Manchin (D-WV), Cindy Hyde-Smith (R-MS), Cory Booker (D-NJ) and Susan Collins (R-ME). A bipartisan House companion bill is also being introduced by Congressmen Mikie Sherrill (D-NJ), Peter King (R-NY), Josh Gottheimer (D-NJ), Tom Reed (R-NY), Tom O'Halleran (D-AZ), Fred Upton (R-MI), Ted Lieu (D-CA), Brian Fitzpatrick (R-PA), Debbie Dingell (D-MI) and Elise Stefanik (R-NY).

The legislation builds upon the $150 billion set aside in the Coronavirus Aid, Relief, and Economic Security (CARES) Act to help state and local governments. However, it eliminates the current 500,000 population threshold in that law, thus allowing every state, county, municipality, U.S. territory and the District of Columbia to qualify for direct federal assistance, regardless of its size. It also loosens regulations restricting the purposes for which the monies could be spent.

The SMART Fund created by the law would target funding for areas of greatest need based upon infection rates and revenue losses. It would provide $500 billion in flexible funding that can be used to directly offset lost revenues. Specifically, after a $16 billion set-aside for Native American tribal governments, the remaining funding would be allocated to states through three equally divided tranches:

- **One-Third Based on Population Size**. This will be allocated to all 50 states, D.C. and U.S. territories in proportion to each respective state or territory's percentage of the U.S. population. Counties and municipalities will each get a share of one-sixth of their state's respective allocation for a combined total of one-third of their state's allocation from this tranche. Funding will be distributed to counties and municipalities based on each county or municipality's proportion of the state's population for this tranche.
- **One-Third Based on Infection Rates**. This tranche of funding will be allocated based on each state's relative share of the nation's infection rate. States that have disproportionately high infection rates will incur significantly higher expenses and will likely need to continue stay-at-home orders for longer periods of time, leading to larger revenue losses. Counties and municipalities will each get a share of one-sixth of their state's respective allocation for a combined total of one-third of their state's allocation from this tranche. Once again, funding will be distributed to counties and municipalities based on each county or municipality's proportion of the state's population for this tranche.
- **One-Third Based on Revenue Losses**. This tranche of funding will be allocated based on each state's revenue loss in proportion to the combined revenue loss of all the states from January 1, 2020 through December 31, 2020. As with the other allocations, counties and municipalities will each get a share of one-sixth of their state's allocation for a combined total of one-third of their state's allocation from this tranche. Funding will be distributed to counties and municipalities based on each county or municipality's revenue loss from January 1, 2020 to December 31, 2020 in proportion to the combined revenue loss for all counties and municipalities in the state over this period. "This is designed to ensure that adequate funding flows to counties and municipalities that are disproportionately affected relative to their population," according to Senator Menendez.

All States, Puerto Rico and the District of Columbia would receive a minimum of $2 billion combined from the first two tranches in addition to their allocation from the third tranche.

To date, the proposal is receiving support from national organizations representing cities, counties and mayors. For example, National Association of Counties (NACo) Executive Director Matthew Chase said the bill "provides essential federal aid for counties at a time when our revenues are plummeting, yet demands for our frontline public health and public safety services are skyrocketing." He said NACo was encouraged by lawmakers on both sides of the aisle working to address the urgent needs of county governments, including their economic response and recovery priorities.

Clarence Anthony, National League of Cities (NLC) CEO and executive director, called the SMART Act “another positive sign that Members of Congress want to help the local leaders they represent.” He said, “momentum is growing for the next emergency response package to include fair and appropriate levels of assistance to all cities, towns, and villages.”

Finally, Tom Cochran, CEO and executive director of The United States Conference of Mayors, stressed the next package that Congress passes “must include strong and flexible fiscal assistance that provides direct emergency relief to all cities and can be used to help mitigate budget shortfalls resulting from the pandemic.”

Should the SMART Act of other legislation like it -- with a prohibition that none of the Federal dollars appropriated be deposited into any State pension fund -- be adopted, how would this provision be implemented by state and local governments? What would the implications be, both legally and politically, on plan sponsor contributions – if any? What could be the unintended consequences of such language? What if similar prohibitions were applied to other Federal revenues provided to the states?

Now is the time to give serious thought to these questions.

- Press Release: “Menendez, Cassidy Introduce Bipartisan SMART Fund to Help Frontline States, Communities in COVID-19 Fight”
- *The Hill*: “Bipartisan Senate group offers new help to state, local governments”

Tennessee Private School Voucher Law Blocked

All things dealing with the COVID-19 crisis have deservedly been in the spotlight and the pandemic is the focus of virtually everyone’s attention. But life goes on otherwise, and important victories should still be celebrated. One such victory took place in Tennessee earlier this month, helping ensure public education funds are used exclusively to maintain, support and strengthen public schools. NCTR thanks commercial associate member Robbins Geller Rudman & Dowd LLP for bringing it to our attention.

Specifically, on May 4, Davidson County Chancellor Anne C. Martin struck down Tennessee’s private school voucher law, known as the Education Savings Account (ESA) Pilot Program.

The ESA Act was passed at the 2019 Session of the 111th Tennessee General Assembly and signed into law by Governor Bill Lee on May 24, 2019. It establishes a program allowing a limited number of eligible students to directly receive their share of the state and local funding that otherwise would be provided to the school system, to pay for private school education and associated expenses. The number of eligible students increases over a five-year period.

The voucher program would only apply to Nashville and Memphis, the areas with the lowest performing schools and regions with Democratic political strongholds. The original version included several other counties, but “it was eventually whittled down after Republican lawmakers objected due to uneasiness about launching a voucher program in their own legislative districts,” according to an article in the *Chattanooga Times Free Press*.

According to press reports, about 300 applications from families appeared to be on track for approval for 5,000 available spots. State officials said they expected about 500 students would participate in the first year, with plans to expand the program eventually to 15,000 students. According to Marta Aldrich, writing in *Chalkbeat Tennessee*, Shelby County Schools and Metropolitan Nashville Public Schools “stood eventually to lose thousands of students and millions of dollars if eligible families opted to shift taxpayer funding from public to private schools for their children.”

Public school parents and community members in Nashville and Memphis brought suit in *McEwen v. Lee*, arguing Republican lawmakers did not receive local consent when drafting legislation affecting local communities, which is required under Tennessee's constitution.

The voucher program was originally intended to begin in the 2021-2022 school year. However, Tennessee’s Governor, Bill Lee (R), decided to issue vouchers starting this fall for the 2020-2021 school year, and began taking applications. Therefore, the McEwen plaintiffs immediately moved for an injunction to temporarily block the law until the court had the opportunity to rule on its constitutionality. Davidson and Shelby counties filed a motion for summary judgment in their separate lawsuit challenging the voucher law.

Chancellor Martin subsequently found “[t]he entire process of the General Assembly, including the amendments and 'horse trading' associated with changing eligibility criteria to satisfy legislators who wanted their counties excluded, resulted in an act that, in form and effect, is local."

The Tennessee Constitution’s so-called “home rule” provision prohibits the legislature from passing laws that single out individual counties unless approved by two-thirds of the members of those counties’ legislative bodies, or a majority of voters. Consequently, Martin declared the ESA Act unconstitutional, unlawful, and unenforceable, and she ordered a permanent injunction preventing state officials from implementing and enforcing it.

Robbins Geller—primarily known for complex litigation emphasizing securities, corporate mergers and acquisitions, shareholder derivative, whistleblower, antitrust, consumer and insurance class actions—is representing the McEwen plaintiffs *pro bono* (without charge). The plaintiffs are also represented by Education Law Center and the Southern Poverty Law Center.

Chris Wood, a partner at Robbins Geller who argued for the McEwen plaintiffs, called Chancellor Martin's ruling "an enormous victory for Tennessee public school students." "This unpopular voucher program was forced on two communities without their consent, and it threatened to drain public resources from already underfunded public schools," he explained. Tennessee "needs to adequately fund our existing public schools, which educate the vast majority of students in Tennessee, instead of trying to send our taxpayer dollars to unaccountable private schools," Wood said.

In her order, Martin authorized the state to take its case to the Tennessee Court of Appeals if the attorney general chooses, but it would be up to that court whether to consider the appeal. According to Attorney General Herbert Slatery III, Tennessee will appeal Martin's ruling.

- *Chattanooga Times Free Press*: **"**Judge rules Tennessee's school voucher law is unconstitutional**"**
- *Chalkbeat Tennessee:* "Judge orders halt to Tennessee's school voucher program, rules law unconstitutional"