**Item No. 14-2(c)**

MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

**REVISED**
**ACTION ITEM**
April 20, 2016

**TO:** Board of Directors

**FROM:** **Public Affairs & Legislation Committee**
(Directors Barbre, Hinman, Tamaribuchi)

Robert Hunter
General Manager

Staff Contact: Heather Baez

**SUBJECT:** **H.R. 4822 (Nunes) – Public Employee Pension Transparency Act**

## STAFF RECOMMENDATION

Staff recommends the Board of Directors vote to support if amended, H.R. 4822 and send a letter to the author and members of the Orange County delegation indicating our support.

The amendment would allow the federal government to provide the same level of bailout support to state and local pension obligations that are made to private pension plans.

## COMMITTEE RECOMMENDATION

Committee voted 3-0 to move the item for Board consideration. However, a list of pros and cons were requested. Those are listed under "Additional Comments." (Also, the staff recommendation was changed from "support" to "support if amended.)

## SUMMARY

H.R. 4822 would amend the Internal Revenue Code of 1986 to provide for reporting and disclosure by State and local public employee retirement pension plans by encouraging state and local government pension plans to disclose the true nature of their liabilities with the Secretary of the Treasury. This information would be available to the public through a searchable website. State and local governments that fail to disclose the requested information would have their federal tax-exempt bonding authority eliminated. The bill also

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|---|---|---|---|
| **Budgeted (Y/N): n/a** | Budgeted amount: | Core x | Choice __ |
| | | | |
| **Fiscal Impact (explain if unbudgeted):** | | | |

expressly states that state and local pension obligations are solely the responsibility of those entities and that the federal government will not provide a bailout.

## ARGUMENTS IN SUPPORT

According to the author's office, public pension accounting should ideally provide citizens and government officials with a sense of how indebted taxpayers are to state and local government employees. However, the government accounting standards currently used allow states to use procedures that understate their liabilities.

Using the revised standards of the Governmental Accounting Standards Board, state and municipal public pension officials have disclosed unfunded liabilities of $1.2 trillion. However, even this number fails to convey the true debt level because public pensions can calculate their liabilities using unreasonably high discount rates. In many instances, they also severely distort the fair market value of assets.  A recently released study by Stanford University Professor of Finance Joshua Rauh published by Stanford's Hoover Institute, estimates the true amount of unfunded liabilities for states and major municipalities, as of 2014, at $3.4 trillion — nearly triple the amount reported by the pension funds themselves.

Under current law, government accounting standards result in public pensions discounting their liabilities at the expected rate of return on their assets.  Economists have stated that this approach is analytically misguided, as the magnitude of pension liabilities should be viewed as independent of how a pension's funds are invested. In practice, these standards set up a false equivalence between pension payments, which are in most cases guaranteed by Constitutional protections, and the much less certain outcome of an investment portfolio.

## ARGUMENTS IN OPPOSITION

According to a letter from the opposition (listed below), "This legislation creates a dangerous precedent with regard to federal taxation and regulation of state and local governments.

The proposal does not protect benefits, save taxpayer dollars or improve retirement system funding. To the contrary, it imposes federal unfunded mandates in areas that are the fiscal responsibility of sovereign States and localities, and is conflicting, administratively burdensome and costly. Further, it threatens to eliminate the tax-exempt bonding authority of state and local governments.

The legislation not only violates the principles of federalism, but represents a fundamental lack of understanding regarding state and local government operations and financing, including governmental accounting rules and strict legal constraints already in place that require open financial reporting and processes. It also ignores the fact that every state and countless localities have recently made modifications to pension financing, benefits structures, or both."

## COMMENTS

Support: National Taxpayers Union, Americans for Tax Reform, American Conservative Union, Citizens Against Government Waste, Americans for Limited Government, Americans for Prosperity, U.S. Chamber of Commerce, Free Enterprise Nation, National Federation of Independent Business

Opposition: National Conference of State Legislatures (NCSL), International Association of Fire Fighters (IAFF), National Association of Counties (NACo), National Association of Police Organizations (NAPO) , United States Conference of Mayors (USCM), National Education Association (NEA), National League of Cities (NLC), American Federation of Teachers (AFT), International City/County Management Association (ICMA)
National Association of State Auditors Comptrollers and Treasurers (NASACT), American Federation of State, County and Municipal Employees (AFSCME), Government Finance Officers Association (GFOA), Service Employees International Union (SEIU), International Public Management Association for Human Resources (IPMA-HR), National Conference of State Social Security Administrators (NCSSSA), National Conference on Public Employee Retirement Systems (NCPERS), National Council on Teacher Retirement (NCTR), National Association of State Retirement Administrators (NASRA)

## DETAILED REPORT

The full text of H.R. 4822 is attached.

## ADDITIONAL COMMENTS

Pros:

This measure would provide citizens and government officials with a sense of how indebted taxpayers are to state and local government employees. It is estimated that State and municipal public pension officials have disclosed unfunded liabilities of $2.4 trillion.

Seeks to prevent more municipal bankruptcies. Sponsors of the measure said Stockton and other distressed cities would not be in such deep trouble — and their workers, residents and bondholders exposed to losses — if they had been reporting more accurately what they had promised to retirees.

The bill would not require governments to change the type of benefits they offer workers, or to invest their retirement money in any particular way. The federal government has little or no power to direct such decisions by states and cities because of state sovereignty provisions in the Constitution.

State budgets are so dependent on federal dollars that Congress does have a role to play crafting federal policies that allow the states maximum discretion to economize and innovate.

Cons:

This measure would strip states and cities of their right to issue tax-exempt bonds unless they first disclosed the true cost of their pension plans and whether they could pay it. They would not be able to borrow money to build schools or other essential infrastructure unless they share complete information on the health of their pension funds to the U.S. Treasury Department.

The federal government would not backstop states, cities or other governments that promised pensions to their workers, despite offering bailouts to failed private pensions.

Opponents argue the bill is a deliberate effort to make pensions look exorbitant, to stoke taxpayer anger and resentment, and heighten the pressure on states and cities to switch to 401(k) plans.

Accounting is primarily the states' responsibility and states are sovereign.  States should be able to gradually solve their underfunding problems with the steps they are already taking like requiring bigger contributions from both workers and governments.

Most of the additional funding needed to cover pension liabilities is likely to take the form of higher government contributions and therefore will require higher taxes or reduced government services for residents.