



REVISED

ACTION ITEM

March 21, 2011

TO: Board of Directors

FROM: **Public Affairs & Legislation Committee**
(Directors Hinman, Dick, Clark)

Kevin Hunt
General Manager

Staff Contact: David Cordero

SUBJECT: ESTABLISHMENT OF LEGISLATIVE POSITIONS

STAFF RECOMMENDATION

Staff recommends the Board of Directors adopt positions on the following legislative bills:

AB 83 (Jeffries)	Environment: CEQA exemption: recycled water pipeline	Support
AB 576 (Dickinson)	Delta Stewardship Council: Planning and Administration: Fee	Oppose unless Amended
AB 741 (Huffman)	Onsite wastewater disposal.	Support
S. 347 (Burr, NC)	Public Employee Pension Transparency Act	Support
H.R. 567 (Nunes, CA)	Public Employee Pension Transparency Act	Support

COMMITTEE RECOMMENDATION

Committee recommends (To be determined at Committee Meeting)

SUMMARY

AB 83 (Jeffries) – Environment: CEQA exemption: recycled water pipeline.

Summary: This bill would exempt new recycled water pipeline installation projects that are to be located under roadways or improved rights-of-way and are less than eight miles in

Budgeted (Y/N):	Budgeted amount:
Action item amount:	Line item:
Fiscal Impact (explain if unbudgeted):	

length from having to prepare and submit certain environmental documentation under the California Environmental Quality Act (CEQA). Presently these types of projects are exempt only if they are less than one mile in length.

Analysis: The California Environmental Quality Act (CEQA) requires a lead agency, as defined, to prepare, or cause to be prepared, and certify the completion of, an environmental impact report (EIR) on a project that it proposes to carry out or approve that may have a significant effect on the environment or to adopt a negative declaration if it finds that the project will not have that effect. CEQA also requires a lead agency to prepare a mitigated negative declaration for a project that may have a significant effect on the environment if revisions in the project would avoid or mitigate that effect and there is no substantial evidence that the project, as revised, would have a significant effect on the environment. CEQA exempts projects for the installation of a new pipeline or the maintenance, repair, restoration, reconditioning, relocation, replacement, removal, or demolition of an existing pipeline that are less than one mile in length and are within a public street or highway or any other public right-of-way.

AB 83 would expand the exemption to projects that are less than eight miles in length for the installation of a new recycled water pipeline within an improved public street, highway, or right-of-way.

According to the bill's author and its proponents, AB 83 would provide significant savings for agencies through decreased administrative costs on projects and increased efficiency in terms of project completion timelines. Potential administrative savings have been estimated to be anywhere from \$15,000 to \$30,000 per project and potential time savings of up to 15 weeks.

AB 83 is sponsored by the Elsinore Valley Municipal Water District, and is currently supported by the Association of California Water Agencies (ACWA), Eastern Municipal Water District, and Walnut Valley Water District. Similar legislation (AB 1704) was introduced by the author in 2010 but it lacked the support necessary to pass the Assembly Natural Resources Committee.

Status: This bill is scheduled to be heard in the Assembly Natural Resources Committee on March 21, 2011.

Recommended Position: *SUPPORT*

AB 576 (Dickinson) – Delta Stewardship Council: Planning and Administration: Fee

Summary: AB 576 would direct the Delta Stewardship Council (the Council) to adopt a fee for State Water Project (SWP) and federal Central Valley Project (CVP) water contractors to fund a portion of the planning and administrative costs of the Council.

Analysis: AB 576 would require the establishment of a fee to be borne exclusively by SWP and CVP water supply contractors to fund a portion of the planning and administrative costs of the Delta Stewardship Council. The bill neither identifies nor proposes any other funding sources to help cover these costs. This runs contrary to the principle of “beneficiaries pay” in which certain costs would be shared among Delta water users and others who benefit

directly from the services or work being performed in the Delta watershed. The SWP and CVP fee would fund a “portion” of the Council’s costs but, since the water contractor fee is the only funding source identified, there is concern that it could be unnecessarily high and, once initiated, it might prove difficult to include other beneficiaries in a long-term financing plan.

The Delta Stewardship Council was formed as part of the State Water Legislative Package that was signed into law in November 2009. The Council is responsible for developing, adopting and commencing implementation of a new Delta Plan that advances the co-equal goals of Delta ecosystem restoration and a reliable water supply. The legislation authorizing the formation of the Council, SB X7-1, did not establish a short-term or long-term financing mechanism for the Council. A combination of funding from the state General Fund, bonds, and/or federal reimbursements are currently providing the initial funding for the Council.

The Metropolitan Water District of Southern California recently adopted an “Oppose unless Amended” position on the bill. Metropolitan is requesting that the bill be amended to make it consistent with the beneficiaries pay approach and that the proposed fee be applied so the Council’s costs are distributed more broadly to all persons or groups that benefit from or cause impacts to the Delta watershed.

Status: This bill has been assigned to the Assembly Water, Parks and Wildlife Committee. A hearing has not yet been scheduled.

Recommended Position: *OPPOSE UNLESS AMENDED*

AB 741 (Huffman) – Onsite wastewater disposal.

Summary: This bill would authorize public wastewater agencies to offer voluntary liens to private property owners to finance the replacement of existing sewer lateral lines or the conversion of an onsite septic system for connection to the community sewer system.

Analysis: AB 741 would modify and expand existing law to allow private property owners to voluntarily enter into agreements with local wastewater agencies for the financing of onsite wastewater infrastructure improvements. It would facilitate conversions from septic systems to community sewer systems and the replacement of sewer lateral lines. In so doing, the bills helps to protect water quality as well as the environment and public health from contamination from leaking septic tanks, eroding pipes and other aging sewer infrastructure.

Existing law (Health & Safety Code, Sections 5460-5464) authorizes a property owner included within an assessment district to enter into an agreement with the local wastewater agency for the financing of sewer improvements to connect to a community sewer system when a regional water quality control board has issued a sewage disposal abatement order. AB 741 would expand this law so such a conversion could be financed without requiring a regional board abatement order. It would also allow this same financing arrangement to be used for the replacement of sewer lateral lines.

According to the bill’s author:

The California State Water Resources Control Board requires wastewater agencies to maintain the public sewer systems, and agencies invest hundreds of millions of dollars in repair and improvements to publicly owned sewer mains and treatment facilities. However, the problem cannot be resolved solely by upgrading the community sewer system. Repair or replacement of sewer laterals is typically the responsibility of the homeowner, but there is no mandate requiring this maintenance. Private property owners must be given the tools to maintain private sewer laterals.

The costs of sewer lateral replacements for private property owners are high. A typical sewer lateral replacement can range from \$1,500 to \$4,000. Costs can increase significantly if there are obstructions such as landscaping, driveways, or structures built above the lateral.

Providing financing options to encourage private property owners to replace their damaged sewer laterals is essential to ensuring that public infrastructure, public health and the environment are protected.

Converting from a septic to sewer system protects water quality, the environment and public health by ensuring that wastewater is collected and conveyed to treatment and disposal facilities with minimal risk and increases water quality benefits.

The cost to convert a septic system to a sewer system can be expensive, including the clean up and removal or abandonment of the septic system as well as the costs of building the facilities needed to connect to the community sewer system. According to the Irvine Ranch Water District [the bill sponsor], the costs of conversion can range from \$2,000 to \$14,000 and if new or replacement pumps are needed, this can add an additional \$10,000.

Status: This bill has been assigned to the Assembly Local Government Committee. A hearing has not yet been scheduled. It also recently acquired two co-authors, Orange County Assemblymembers Don Wagner (AD 70) and Jeff Miller (AD 71).

Recommended Position: *SUPPORT*

The Public Pension Transparency Act – H.R. 567 (Nunes, R-CA) / S. 347 (Burr, R-NC)

Summary: The Public Employee Pension Transparency Act amends the Internal Revenue Code to deny tax benefits relating to bonds issued by a state or political subdivision during any period in which such state or political subdivision is noncompliant with specified reporting requirements for state or local government employee pension benefit plans. It requires plan sponsors of a state or local government employee pension benefit plan to file with the Secretary of the Treasury an annual report setting forth:

- (1) a schedule of the funding status of the plan;
- (2) a schedule of contributions by the plan sponsor for the plan year;

- (3) alternative projections for each of the next 20 plan years relating to the amount of annual contributions, the fair market value of plan assets, current liability, the funding percentage, and other matters specified by the Secretary;
- (4) a statement of the actuarial assumptions used for the plan year;
- (5) a statement of the number of plan participants who are retired or separated from service and are either receiving benefits or are entitled to future benefits and those who are active under the plan;
- (6) a statement of the plan's investment returns;
- (7) a statement of the degree to which unfunded liabilities are expected to be eliminated; and
- (8) a statement of the amount of pension obligation bonds outstanding.

The Act also directs the Secretary of the Treasury to develop model reporting statements and create and maintain a public website, with searchable capabilities, for purposes of posting plan information required by the Act.

Analysis: The Public Affairs and Legislation Committee was presented in February with background information and an introductory version of the Public Employee Pension Transparency Act, new legislation sponsored by Congressman Deven Nunes (R-CA). The bill is now known as H.R. 567 and an identical Senate companion bill, S. 347, sponsored by Senator Richard Burr (R-NC), has also been introduced.

According to Congressman Nunes, state and local governments have promised pension benefits to about 20 million active public employees and another seven million retirees and dependents nationwide. The Pew Center on the States, a division of the non-profit Pew Charitable Trusts that identifies and advances effective solutions to critical issues facing states, reported last year that there is a nationwide under-funding of pension and other retirement benefits of about \$1 trillion in the aggregate. Additionally, in 2008, only four states had fully-funded pension systems – down from over one-half of all states in 2000.

Congressman Nunes is concerned that “...the vast majority of the American people are unaware that their state and local governments collectively owe trillions of dollars for generous public employee pension benefits.” This is largely due to the different accounting and reporting practices employed by public sector agencies as opposed to the standards in place for the private sector.

Critics of the accounting standards employed by public employee pension plans have stated that, “unlike private pension plans, public employee pension plans are allowed to use unreasonably high discount rates to calculate their liabilities. In fact, many use unrealistic expected rates of returns on their plan assets, the value of which is often inflated, to discount their pension liabilities. Many economists maintain that these practices are misguided and hide the fact that State and local government pension plans are collectively underfunded by more than \$3.8 trillion.” Critics also assert that “while the private sector is held to stringent funding requirements under the Employee Retirement Income Security Act, which can adversely affect wages and benefits for workers as funding shortages are

addressed, the public sector often remains free to promise increasing levels of benefits without properly funding those benefits for the future.”

The Public Employee Pension Transparency Act would address this situation by requiring State and local government pension plans to disclose their plan liabilities and investment assumptions using an accounting standard that provides realistic rates of return. The plans would have to use the Treasury discount rate (just over 4%) rather than higher rates which allow them to assume larger investment gains. It would also tie assets to more reasonable fair market valuations. Critics of the accounting standards employed by many state and local government pension plans believe public systems understate their unfunded liabilities by manipulating the way the information is reported.

H.R. 567 and S. 347 would condition the continuation of specified federal tax benefits upon State and local governments’ decision to file certain information regarding their pension plans with the Secretary of the Treasury. In other words, state and local public employee pension plans would not be forced to comply with the federal law but non-compliance would result in forfeiture of their ability to sell and issue federally subsidized, tax-exempt bonds, which are used to finance infrastructure construction and related purposes. This “carrot and stick” approach is similar to that which is employed by the State of California in which water agency eligibility for state grants and loans are conditioned on their implementation of certain water conservation or other water-use standards.

Finally, the Public Employee Pension Transparency Act reaffirms that State and local agency pension obligations are solely the responsibility of those entities that provide the benefits and that the federal government will not provide financial assistance to those agencies to meet their obligations (i.e. the federal government will not provide public pension bailouts). While there are no known case in which a state or local public employee pension plan has requested financial assistance from the federal government, the Public Employee Pension Transparency Act advances this policy based on recent examples of financially troubled industries being bailed out by the federal government (i.e. the taxpayer) when their own financial situations spiraled out of control.

The Public Employee Pension Transparency Act was the focus of a Wall Street Journal editorial that was published on January 22, 2011:

Public Pension Hygiene Act

The first reform step is exposing the true size of the funding hole.

We're so accustomed to misnamed legislation like the Employee Free Choice Act (card check) that it's hard to believe that a welcome proposal called the Public Employee Pension Transparency Act describes what it actually purports to do. To wit, prohibit public pension bailouts by the federal government and expose the \$3.5 trillion of unfunded public pension liabilities that local and state governments have obscured.

Most state and local governments currently use their own estimated rate of return on their investments to discount their liabilities. By projecting unrealistically high rates of return, states minimize their unfunded liabilities, at least on paper. Lower unfunded liabilities in turn allow them to reduce how much they and public employees must

contribute to their pension funds. Inflated investment assumptions are one reason that public pension funds are unfunded to the tune of \$3.5 trillion.

Public pensions typically assume an 8% annual return on average, but over the past five years state pension funds with more than \$5 billion in assets have earned only 4.5%. Taxpayers must make up the difference between what the funds earn and what they need to pay retirees. For Californians that is roughly \$5 billion this year.

Local taxpayers are already seeing their services whacked and taxes raised to fill these pension holes. University of California students will have to pony up 8% more next year for tuition to offset an expected \$500 million in state budget cuts. Illinois residents will soon pay 67% more in income taxes, but taxpayers won't feel the full brunt for another decade when the funds begin running out of money. When Chicago's pension fund goes dry around 2019, over half of the city's revenue will be dedicated to pensions.

In the 1950s and 1960s, many private employers obscured their liabilities the way governments are doing today, though they didn't have a public backstop. Many funds went broke. In 1974 Congress established minimum funding requirements and penalized companies that underfunded pensions. The law also required companies to report and discount their liabilities using a more conservative rate of return.

These changes exploded liabilities and prompted many companies to switch from defined-benefit plans to defined-contribution plans like 401(k)s. While a majority of private workers now have defined-contribution plans, defined-benefit plans remain the norm in government.

Enter the Public Employee Pension Transparency Act, which is sponsored by House Republicans Devin Nunes and Darrell Issa of California and Wisconsin's Paul Ryan. Their bill would encourage governments to switch to defined-contribution plans by revealing the true magnitude of their unfunded liabilities. States and municipalities would have to report their liabilities to the U.S. Treasury using their own rosy investment forecasts as well as a more realistic Treasury bond rate (to be determined by a formula).

This data would make clear how much taxpayers potentially owe and increase pressure on lawmakers to fix their plans. For instance, Illinois estimated in 2009 that it had a roughly \$85 billion unfunded liability. Using a Treasury discount rate, that unfunded liability balloons to \$167 billion.

Out of respect for state sovereignty, the federal government shouldn't and can't tell local governments how to run or fund their pensions. But the bill doesn't do so and it also doesn't force states to fund their plans using a lower discount rate. States don't even have to comply with the law, though they would forego their ability to sell federally subsidized, tax-exempt bonds if they don't.

The bill may not persuade states like Illinois and California to revamp their pensions, but it will reveal how broken they are—and that's a start.

There have also been arguments made against the Public Employee Pension Transparency Act – most recently in a March 15, 2001 report issued by the Center on Budget and Policy Priorities (CBPP), which bills itself as “one of the nation’s premier policy organizations working at the federal and state levels on fiscal policy and public programs that affect low- and moderate-income families and individuals.”

The CBPP report argues that:

There is clearly a need to standardize state and local pension reporting and make it more transparent. Extensive work on these matters by an expert, non-political board that enjoys respect in financial markets — the Governmental Accounting Standards Board — is now nearing completion. GASB is on track to issue new standards next year for state and local government reporting on the financial status of their pension funds.

The Nunes bill, however, would effectively short-circuit and override the GASB process by issuing a federal edict on how pension funds are to report liabilities. It would be unsound policy to substitute heavy-handed and unnecessary federal intrusion... for the GASB standards and the financial market discipline that induces state and local governments to comply with those standards.

There are a number of other, related problems with the Nunes proposal, as well, including:

- *It could sow public confusion, as it would likely lead the public and many policymakers to believe that the amounts that states and localities need to deposit in their pension plans each year are substantially larger than the amounts actually needed. Misunderstanding of the level of contributions required could lead to excessive cuts in other parts of state budgets (such as education) and/or greater-than-needed tax increases in order to free up more room in state budgets for the greatly increased pension contributions; it also could generate pressure to end defined-benefit pension plans.*
- *It would fail to accomplish its stated objective of allowing observers to compare the funding status of pensions on an “apples-to-apples” (or standardized) basis because it would set standards for only two of the array of variables that are used to calculate pension-fund liabilities.*
- *A new federal bureaucracy would have to be created to gather, process, and verify the information for the nation’s 2,550 state and local pension plans and to apply and enforce any penalties that would have to be applied under the legislation. The new bureaucracy would be created at a time when the federal government is trying to cut costs.*
- *The legislation could unnecessarily spook the bond markets, leading to higher borrowing costs for states and localities.*

The full CBPP report may be viewed here... <http://www.cbpp.org/files/3-15-11sfp.pdf> or as an attachment to this staff report.

MWDOC staff, including the Director of Finance, has reviewed H.R. 567 and S. 347 and believes that the Public Employee Pension Transparency Act would improve transparency in the reporting of public employee pension plan liabilities, assets, and other information of interest to taxpayers. Staff believes that full disclosure of these pension plan components should be a standard accounting reporting practice across the public and private sectors and, should the Public Employee Pension Transparency Act become law, MWDOC believes it would have no difficulty complying with the new requirements.

There are significant policy, political, and philosophical arguments to be made in support of establishing new Congressionally-established accounting and reporting standards for state and local public employee pension plans. Given the likely trillions of dollars in unfunded liabilities that currently exist and the risk that poses to taxpayers and the future solvency of state and local governments, it is hard to say that preserving the status quo is acceptable. The ability for the public employee pension plans to calculate and report their liabilities and assets differently than the private sector does create confusion for taxpayers and taxpayer advocates and watchdog groups. It also has an impact on the nation's financial markets with regard to bond sales and other business transactions with public entities whose long-term finances may not be as stable as they report.

The reforms being developed by the Governmental Accounting Standards Board (GASB) may, in fact, eliminate some or many of the practices that have allowed public agencies to obscure the true size of their pension liabilities and under-fund their plans for so long. But the questions must be asked, will the GASB reforms achieve enough meaningful change in the form of increased transparency as well as public agency pension plan management and funding policies that will keep the plans sustainable in the long-term?

Staff believes the Public Employee Pension Transparency Act can ensure that meaningful change does occur at a time when taxpayers find themselves increasingly "on the hook" to fund public pension plans but "in the dark" about how extensively the plans may be in the red. Therefore, staff recommends supporting H.R. 567 and S. 347.

Status: H.R. 567 has been assigned to House Committee on Ways and Means. S. 347 has been assigned to the Senate Committee on Finance.

Recommended Position: *SUPPORT*

Attachments:

- 1) AB 83 (Jeffries)
- 2) AB 576 (Dickinson)
- 3) AB 741 (Huffman)
- 4) S. 347 (Burr, NC)
- 5) H.R. 567 (Nunes, CA)
- 6) Center on Budget and Policy Priorities Report

ASSEMBLY BILL

No. 83

Introduced by Assembly Member Jeffries

January 5, 2011

An act to amend Section 21080.21 of the Public Resources Code, relating to the environment.

LEGISLATIVE COUNSEL'S DIGEST

AB 83, as introduced, Jeffries. Environment: CEQA exemption: recycled water pipeline.

(1) The California Environmental Quality Act (CEQA) requires a lead agency, as defined, to prepare, or cause to be prepared, and certify the completion of, an environmental impact report (EIR) on a project that it proposes to carry out or approve that may have a significant effect on the environment or to adopt a negative declaration if it finds that the project will not have that effect. CEQA also requires a lead agency to prepare a mitigated negative declaration for a project that may have a significant effect on the environment if revisions in the project would avoid or mitigate that effect and there is no substantial evidence that the project, as revised, would have a significant effect on the environment. CEQA exempts specified pipeline projects from the above requirements.

This bill would additionally exempt a project for the installation of a new pipeline, not exceeding a specified length, for the distribution of recycled water within an improved public street, highway, or right-of-way. Because a lead agency, which may include a local agency, is required to determine whether a project qualifies for those exemptions, this bill would impose a state-mandated local program.

(2) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: majority. Appropriation: no. Fiscal committee: yes.
 State-mandated local program: yes.

The people of the State of California do enact as follows:

1 SECTION 1. Section 21080.21 of the Public Resources Code
 2 is amended to read:

3 21080.21. (a) This division does not apply to any project of
 4 less than one mile in length within a public street ~~or highway or~~
 5 ~~any other public, highway, or right-of-way~~ for the installation of
 6 a new pipeline or the maintenance, repair, restoration,
 7 reconditioning, relocation, replacement, removal, or demolition
 8 of an existing pipeline. ~~For purposes of this section, “pipeline”~~
 9 ~~includes subsurface facilities but does not include any surface~~
 10 ~~facility related to the operation of the underground facility.~~

11 (b) *This division does not apply to a project of less than eight*
 12 *miles in length for the installation of a new pipeline for the*
 13 *distribution of recycled water, as defined in Section 13050 of the*
 14 *Water Code, within a paved public street, highway, or right-of-way.*

15 (c) *For the purposes of this section, “pipeline” includes*
 16 *subsurface facilities but does not include any surface facility*
 17 *related to the operation of an underground facility.*

18 (d) *This section does not limit an obligation to conduct a study*
 19 *for a pipeline project, including a traffic study, required pursuant*
 20 *to other law.*

21 SEC. 2. No reimbursement is required by this act pursuant to
 22 Section 6 of Article XIII B of the California Constitution because
 23 a local agency or school district has the authority to levy service
 24 charges, fees, or assessments sufficient to pay for the program or
 25 level of service mandated by this act, within the meaning of Section
 26 17556 of the Government Code.

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ASSEMBLY BILL

No. 576

Introduced by Assembly Member Dickinson

February 16, 2011

An act to add Section 85215 to the Water Code, relating to the Sacramento-San Joaquin Delta.

LEGISLATIVE COUNSEL'S DIGEST

AB 576, as introduced, Dickinson. Delta Stewardship Council: planning and administration: fee.

The Sacramento-San Joaquin Delta Reform Act of 2009 establishes the Delta Stewardship Council, and requires the council, on or before January 1, 2012, to develop, adopt, and commence implementation of a comprehensive management plan for the Sacramento-San Joaquin Delta (Delta Plan), meeting specified requirements.

This bill would require the council, by March 31, 2012, to adopt a fee on water supply contractors of the State Water Project and the federal Central Valley Project to fund a portion of the planning and administrative costs of the council.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 85215 is added to the Water Code, to
- 2 read:
- 3 85215. On or before March 31, 2012, the council shall adopt
- 4 a fee on water supply contractors of the State Water Project and

- 1 the federal Central Valley Project to fund a portion of the planning
- 2 and administrative costs of the council.

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AMENDED IN ASSEMBLY MARCH 14, 2011

CALIFORNIA LEGISLATURE—2011–12 REGULAR SESSION

ASSEMBLY BILL

No. 741

Introduced by Assembly Member Huffman
(Coauthors: Assembly Members Miller and Wagner)

February 17, 2011

An act to add Section 5465 to the Health and Safety Code, relating to wastewater.

LEGISLATIVE COUNSEL'S DIGEST

AB 741, as amended, Huffman. Onsite wastewater disposal ~~conversion~~.

Existing law prohibits the discharge of sewage or other waste, or the effluent of treated sewage or other waste, in any manner ~~which~~ *that* will result in contamination, pollution, or a nuisance. Under existing law, when the State Department of Public Health or any local health officer finds that a contamination exists, the department or the officer is required to order the contamination abated, as provided.

Under existing law, an owner or reputed owner of property included within an assessment district for construction of a main trunkline or collector sewer lines may request the governing board to construct all necessary plumbing to connect his or her property to the adjoining public sewer system, the cost of ~~the~~ which constitutes a lien on the property.

This bill would authorize ~~specified~~ *defined* entities, ~~as defined~~, to use this provision for the purpose of converting properties from onsite septic systems and connecting them to the sewer system *and for replacing existing sewer laterals connecting pipes to a sewer system*.

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 5465 is added to the Health and Safety
2 Code, to read:
3 5465. (a) The procedures specified in this section may be used
4 by a public agency that is an entity, as defined in Section 5470.
5 ~~(b) An entity may use the procedures specified in Section 5464~~
6 ~~for the purpose of converting properties from onsite septic systems~~
7 ~~and connecting them to a sewer system, whether or not an order~~
8 ~~or other action shall have been issued or taken for an abatement~~
9 ~~of contamination created by sewage disposal. The conversion~~
10 ~~improvements and costs may include, but are not limited to, pipes,~~
11 ~~pumps and other equipment, septic system abandonment, and~~
12 ~~associated sewage treatment capacity.~~
13 *(b) An entity may use the procedures specified in Section 5464*
14 *for either of the following purposes, whether or not an order or*
15 *other action has been issued or taken for an abatement of*
16 *contamination created by sewage disposal:*
17 *(1) Converting properties from onsite septic systems and*
18 *connecting them to a sewer system. The conversion improvements*
19 *and costs may include, but are not limited to, pipes, pumps and*
20 *other equipment, septic system abandonment, and associated*
21 *sewage treatment capacity.*
22 *(2) Replacing existing sewer laterals connecting pipes to a sewer*
23 *system. The cost of the lateral replacement shall constitute the cost*
24 *of an improvement for connection to a sewer system.*
25 (c) For purposes of this section, and in addition to any other
26 power, an entity may exercise the powers specified in Article 4
27 (commencing with Section 5470).
28 (d) The authority granted by this section shall be in addition to,
29 shall not be in derogation of, and shall not affect, any authority
30 granted by other law relating to recovering the cost incurred by an
31 entity for connecting properties to the public sewer system, or the
32 entity’s exercise of powers pursuant to any other law. This section
33 shall be deemed to provide a complete and supplemental method
34 for exercising the powers authorized by this section, and shall be

1 deemed supplemental to the powers conferred by other applicable
2 laws.

3 (e) For purposes of this section, the following definitions shall
4 apply:

5 (1) “Assessment district” as used in statutes referenced in this
6 section also means an improvement district or any other area served
7 by the entity’s sewer collection system.

8 (2) “Governing board” and “governing body” mean the
9 governing body of the entity.

10 (3) “Ordinance” as used in statutes referenced in this section
11 also means a resolution.

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112TH CONGRESS
1ST SESSION

S. 347

To amend the Internal Revenue Code of 1986 to provide for reporting and disclosure by State and local public employee retirement pension plans.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 15, 2011

Mr. BURR (for himself, Mr. THUNE, Mr. COBURN, Mr. ISAKSON, Mr. ENSIGN, Mr. GRASSLEY, and Mr. KYL) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to provide for reporting and disclosure by State and local public employee retirement pension plans.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Public Employee Pen-
5 sion Transparency Act”.

6 **SEC. 2. FINDINGS.**

7 The Congress finds the following:

8 (1) Pursuant to clauses 1 and 3 of section 8 of
9 article I of the Constitution of the United States,

1 the Congress has the authority to condition the con-
2 tinuation of certain specified Federal tax benefits
3 upon State or local government employee pension
4 benefit plans provision of meaningful disclosure
5 under section 4980J of the Internal Revenue Code
6 of 1986, as added by this Act.

7 (2) State or local government employee pension
8 benefit plans have promised pension benefits to ap-
9 proximately 20 million Americans who are active em-
10 ployees of these entities. An additional 7 million re-
11 tirees and their dependents currently receive benefits
12 from State or local government employee pension
13 benefit plans. The interests of participants in many
14 of such plans are in the nature of property rights
15 under State law.

16 (3) State or local government employee pension
17 benefit plans are substantially facilitated by the fa-
18 vorable tax treatment of participants and bene-
19 ficiaries, investment earnings, and employee con-
20 tributions with respect to such plans provided by the
21 Federal Government under the Internal Revenue
22 Code of 1986.

23 (4) The investment of State or local govern-
24 ment employee pension benefit plan assets, the dis-
25 tribution of benefits under such plans, and other re-

1 lated financial activities are facilitated through the
2 use of instrumentalities of, and substantially affect,
3 interstate commerce. These activities, which are
4 interstate in nature and have a substantial impact
5 on the national economy, affect capital formation,
6 regional growth and decline, the national markets
7 for insurance, and the markets for securities and the
8 trading of securities of State and local governments.

9 (5) The financial status of State or local gov-
10 ernment employee pension benefit plans also has a
11 direct impact on the national markets for insurance
12 and trading of securities of State and local govern-
13 ments.

14 (6) State or local government employee pension
15 benefit plans additionally have a substantial impact
16 on interstate commerce as a consequence of the
17 interstate movement of participants.

18 (7) State or local government employee pension
19 benefit plans are becoming a large financial burden
20 on certain State and local governments and have al-
21 ready resulted in tax increases and the reduction of
22 services.

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24 Journal of Economic Perspectives found that the
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2 that these pension plans are unfunded by \$3.23 tril-
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4 funded liability for all municipal plans in the United
5 States is \$574 billion.

6 (9) Some economists and observers have stated
7 that the extent to which State or local government
8 employee pension benefit plans are underfunded is
9 obscured by governmental accounting rules and
10 practices, particularly as they relate to the valuation
11 of plan assets and liabilities. This results in a
12 misstatement of the value of plan assets and an un-
13 derstatement of plan liabilities, a situation that
14 poses a significant threat to the soundness of State
15 and local budgets.

16 (10) There currently is a lack of meaningful
17 disclosure regarding the value of State or local gov-
18 ernment employee pension benefit plan assets and li-
19 abilities. This lack of meaningful disclosure poses a
20 direct and serious threat to the financial stability of
21 such plans and their sponsoring governments, im-
22 pairs the ability of State and local government tax-
23 payers and officials to understand the financial obli-
24 gations of their government, and reduces the likeli-
25 hood that State and local government processes will

1 be effective in assuring the prudent management of
2 their plans. The status quo also constitutes a serious
3 threat to the future economic health of the Nation
4 and places an undue burden upon State and local
5 government taxpayers, who will be called upon to
6 fully fund existing, and future, pension promises.

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9 interest and meaningful disclosure of the value of
10 their assets and liabilities is necessary and desirable
11 in order to adequately protect plan participants and
12 their beneficiaries and the general public. Meaning-
13 ful disclosure would also further efforts to provide
14 for the general welfare and the free flow of com-
15 merce.

16 **SEC. 3. REPORTING OF INFORMATION WITH RESPECT TO**
17 **STATE OR LOCAL GOVERNMENT EMPLOYEE**
18 **PENSION BENEFIT PLANS TREATED AS A TAX**
19 **EXEMPTION, ETC., REQUIREMENT FOR STATE**
20 **AND LOCAL BONDS.**

21 (a) IN GENERAL.—Subpart B of part IV of sub-
22 chapter B of chapter 1 of the Internal Revenue Code of
23 1986 (relating to requirements applicable to all State and
24 local bonds) is amended by adding at the end the following
25 new section:

1 **“SEC. 149A. REPORTING WITH RESPECT TO STATE OR**
2 **LOCAL GOVERNMENT EMPLOYEE PENSION**
3 **BENEFIT PLANS.**

4 “(a) IN GENERAL.—In the case of a failure to satisfy
5 any requirement of subsection (a) or (b) of section 4980J
6 (relating to failure of State or local government employee
7 pension benefit plans to meet reporting requirements) with
8 respect to any plan maintained with respect to employees
9 of one or more States or political subdivisions of one or
10 more States, no specified Federal tax benefit shall be al-
11 lowed or made with respect to any specified bond issued
12 by any such State or political subdivision (or by any bond-
13 ing authority acting on behalf, or for the benefit, of such
14 State or political subdivision) during the noncompliance
15 period.

16 “(b) NONCOMPLIANCE PERIOD.—For purposes of
17 this section, the term ‘noncompliance period’ means, with
18 respect to any State or political subdivision in connection
19 with any failure, the period beginning on the date that
20 the Secretary notifies such State or political subdivision
21 of such failure and ending on the date that such failure
22 is cured (as determined by the Secretary).

23 “(c) SPECIFIED BOND.—For purposes of this section,
24 the term ‘specified bond’ means—

25 “(1) any State or local bond within the meaning
26 of section 103,

1 “(2) any qualified tax credit bond within the
2 meaning of section 54A, and

3 “(3) any build America bond within the mean-
4 ing of section 54AA.

5 “(d) SPECIFIED FEDERAL TAX BENEFIT.—For pur-
6 poses of this section, the term ‘specified Federal tax ben-
7 efit’ means—

8 “(1) any exemption from gross income allowed
9 under section 103 (relating to interest on State and
10 local bonds),

11 “(2) any credit allowed under section 54A (re-
12 lating to credit to holders of qualified tax credit
13 bonds),

14 “(3) any credit allowed under section 54AA (re-
15 lating to build America bonds), and

16 “(4) any credit or payment allowed or made
17 under section 6431 (relating to credit for qualified
18 bonds allowed to issuer).”.

19 (b) REPORTING REQUIREMENTS.—Chapter 43 of
20 such Code is amended by adding at the end the following
21 new section:

1 **“SEC. 4980J. FAILURE OF STATE OR LOCAL GOVERNMENT**
2 **EMPLOYEE PENSION BENEFIT PLANS TO**
3 **MEET REPORTING REQUIREMENTS.**

4 “(a) ANNUAL REPORT.—For purposes of section
5 149A, the requirements of this subsection are as follows:

6 “(1) IN GENERAL.—The plan sponsor of a
7 State or local government employee pension benefit
8 plan shall file with the Secretary, in such form and
9 manner as shall be prescribed by the Secretary, a re-
10 port for each plan year beginning on or after Janu-
11 ary 1, 2011, setting forth the following information
12 with respect to the plan, as determined by the plan
13 sponsor as of the end of such plan year:

14 “(A) A schedule of funding status, which
15 shall include a statement as to the current li-
16 ability of the plan, the amount of plan assets
17 available to meet that liability, the amount of
18 the net unfunded liability (if any), and the
19 funding percentage of the plan.

20 “(B) A schedule of contributions by the
21 plan sponsor for the plan year, indicating which
22 are or are not taken into account under sub-
23 paragraph (A).

24 “(C) Alternative projections which shall be
25 specified in regulations of the Secretary for
26 each of the next 20 plan years following the

1 plan year relating to the amount of annual con-
2 tributions, the fair market value of plan assets,
3 current liability, the funding percentage, and
4 such other matters as the Secretary may specify
5 in such regulations, together with a statement
6 of the assumptions and methods used in con-
7 nection with such projections, including as-
8 sumptions related to funding policy, plan
9 changes, future workforce projections, future
10 investment returns, and such other matters as
11 the Secretary may specify in such regulations.
12 The Secretary shall specify in such regulations
13 the projection assumptions and methods to be
14 used as necessary to achieve comparability
15 across plans.

16 “(D) A statement of the actuarial assump-
17 tions used for the plan year, including the rate
18 of return on investment of plan assets and as-
19 sumptions as to such other matters as the Sec-
20 retary may prescribe by regulation.

21 “(E) A statement of the number of partici-
22 pants who are each of the following—

23 “(i) those who are retired or sepa-
24 rated from service and are receiving bene-
25 fits,

1 “(ii) those who are retired or sepa-
2 rated and are entitled to future benefits,
3 and

4 “(iii) those who are active under the
5 plan.

6 “(F) A statement of the plan’s investment
7 returns, including the rate of return, for the
8 plan year and the 5 preceding plan years.

9 “(G) A statement of the degree to which,
10 and manner in which, the plan sponsor expects
11 to eliminate any unfunded current liability that
12 may exist for the plan year and the extent to
13 which the plan sponsor has followed the plan’s
14 funding policy for each of the preceding 5 plan
15 years. The Secretary shall prescribe by regula-
16 tion the specific criteria to be used for meeting
17 the requirements of this paragraph.

18 “(H) A statement of the amount of pen-
19 sion obligation bonds outstanding.

20 “(2) TIMING OF REPORT.—The plan sponsor of
21 a State or local government employee pension ben-
22 efit plan shall make the filing required under para-
23 graph (1) for each plan year not later than 210 days
24 after the end of such plan year (or within such time

1 as may be required by regulations prescribed by the
2 Secretary in order to reduce duplicative filing).

3 “(b) ADDITIONAL REPORTING REQUIREMENTS.—
4 For purposes of section 149A, the requirements of this
5 subsection are as follows:

6 “(1) SUPPLEMENTARY REPORTS.—In any case
7 in which, in determining the information filed in the
8 annual report for a plan year under subsection (a)—

9 “(A) the value of plan assets is determined
10 using a standard other than fair market value,
11 or

12 “(B) the interest rate or rates used to de-
13 termine the value of liabilities or as the dis-
14 count value for liabilities are not the interest
15 rates described in paragraph (3),

16 the plan sponsor shall include in the annual report
17 filed for such plan year pursuant to subsection (a)
18 the supplementary report for such plan year de-
19 scribed in paragraph (2) of this subsection.

20 “(2) USE OF PRESCRIBED VALUATION METHOD
21 AND INTEREST RATES.—A supplementary report for
22 a plan year filed for a plan year pursuant to this
23 subsection shall include the information specified as
24 required in the annual report under subparagraphs
25 (A), (C), (F), and (G) of subsection (a)(1), deter-

1 mined as of the end of such plan year by valuing
2 plan assets at fair market value and by using the in-
3 terest rates described in paragraph (3) to value li-
4 abilities and as the discount value for liabilities.

5 “(3) INTEREST RATES BASED ON U.S. TREAS-
6 URY OBLIGATION YIELD CURVE RATE.—

7 “(A) IN GENERAL.—The interest rates de-
8 scribed in this subsection are—

9 “(i) in the case of benefits reasonably
10 determined to be payable during the 5-year
11 period beginning on the first day of the
12 plan year, the first segment rate with re-
13 spect to the applicable month,

14 “(ii) in the case of benefits reasonably
15 determined to be payable during the 15-
16 year period beginning at the end of the pe-
17 riod described in subparagraph (A), the
18 second segment rate with respect to the
19 applicable month, and

20 “(iii) in the case of benefits reason-
21 ably determined to be payable after the pe-
22 riod described in clause (ii), the third seg-
23 ment rate with respect to the applicable
24 month.

1 “(B) SEGMENT RATES.—For purposes of
2 this paragraph—

3 “(i) FIRST SEGMENT RATE.—The
4 term ‘first segment rate’ means, with re-
5 spect to any month, the single rate of in-
6 terest which shall be determined by the
7 Secretary for such month on the basis of
8 the U.S. Treasury obligation yield curve
9 for such month, taking into account only
10 that portion of such yield curve which is
11 based on obligations maturing during the
12 5-year period commencing with such
13 month.

14 “(ii) SECOND SEGMENT RATE.—The
15 term ‘second segment rate’ means, with re-
16 spect to any month, the single rate of in-
17 terest which shall be determined by the
18 Secretary for such month on the basis of
19 the U.S. Treasury obligation yield curve
20 for such month, taking into account only
21 that portion of such yield curve which is
22 based on obligations maturing during the
23 15-year period beginning at the end of the
24 period described in clause (i).

1 “(iii) THIRD SEGMENT RATE.—The
2 term ‘third segment rate’ means, with re-
3 spect to any month, the single rate of in-
4 terest which shall be determined by the
5 Secretary for such month on the basis of
6 the U.S. Treasury obligation yield curve
7 for such month, taking into account only
8 that portion of such yield curve which is
9 based on obligations maturing during peri-
10 ods beginning after the period described in
11 clause (ii).

12 “(C) U.S. TREASURY OBLIGATION YIELD
13 CURVE.—For purposes of this subsection, the
14 term ‘U.S. Treasury obligation yield curve’
15 means, with respect to any month, a yield curve
16 which shall be prescribed by the Secretary for
17 such month and which reflects the average, for
18 the 24-month period ending with the month
19 preceding such month, of monthly yields on in-
20 terest-bearing obligations of the United States.

21 “(c) DEFINITIONS.—For purposes of this section—

22 “(1) STATE OR LOCAL GOVERNMENT EM-
23 PLOYEE PENSION BENEFIT PLAN.—The terms ‘State
24 or local government employee pension benefit plan’
25 and ‘plan’ mean any plan, fund, or program, other

1 than a defined contribution plan (within the mean-
2 ing of section 414(i)), which was heretofore or is
3 hereafter established or maintained, in whole or in
4 part, by a State, a political subdivision of a State,
5 or any agency or instrumentality of a State or polit-
6 ical subdivision of a State, to the extent that by its
7 express terms or as a result of surrounding cir-
8 cumstances such plan, fund, or program—

9 “(A) provides retirement income to em-
10 ployees, or

11 “(B) results in a deferral of income by em-
12 ployees for periods extending to the termination
13 of covered employment or beyond, regardless of
14 the method of calculating the contributions
15 made to the plan, the method of calculating the
16 benefits under the plan, or the method of dis-
17 tributing benefits from the plan.

18 “(2) FUNDING PERCENTAGE.—The term ‘fund-
19 ing percentage’ for a plan year means the ratio (ex-
20 pressed as a percentage) which—

21 “(A) the value of plan assets as of the end
22 of the plan year bears to

23 “(B) the current liability of the plan for
24 the plan year.

1 “(3) CURRENT LIABILITY.—The term ‘current
2 liability’ of a plan for a plan year means the present
3 value of all benefits accrued or earned under the
4 plan as of the end of the plan year.

5 “(4) PLAN SPONSOR.—The term ‘plan sponsor’
6 means, in connection with a State or local govern-
7 ment employee pension benefit plan, the State, polit-
8 ical subdivision of a State, or agency or instrumen-
9 tality of a State or a political subdivision of a State
10 which establishes or maintains the plan.

11 “(5) PARTICIPANT.—

12 “(A) IN GENERAL.—The term ‘participant’
13 means, in connection with a State or local gov-
14 ernment employee pension benefit plan, an indi-
15 vidual—

16 “(i) who is an employee or former em-
17 ployee of a State, political subdivision of a
18 State, or agency or instrumentality of a
19 State or a political subdivision of a State
20 which is the plan sponsor of such plan, and

21 “(ii) who is or may become eligible to
22 receive a benefit of any type from such
23 plan or whose beneficiaries may be eligible
24 to receive any such benefit.

1 “(B) BENEFICIARY.—The term ‘bene-
2 fiary’ means a person designated by a partici-
3 pant, or by the terms of the plan, who is or
4 may become entitled to a benefit thereunder.

5 “(6) PLAN YEAR.—The term ‘plan year’ means,
6 in connection with a plan, the calendar or fiscal year
7 on which the records of the plan are kept.

8 “(7) STATE.—The term ‘State’ includes any
9 State of the United States, the District of Columbia,
10 the Commonwealth of Puerto Rico, the Virgin Is-
11 lands, American Samoa, Guam, and the Common-
12 wealth of the Northern Mariana Islands.

13 “(8) FAIR MARKET VALUE.—The term ‘fair
14 market value’ has the meaning of such term under
15 section 430(g)(3)(A) (without regard to section
16 430(g)(3)(B)).

17 “(d) MODEL REPORTING STATEMENT.—The Sec-
18 retary shall develop model reporting statements for pur-
19 poses of subsections (a) and (b). Plan sponsors of State
20 or local government employee pension plans may elect, in
21 such form and manner as shall be prescribed by the Sec-
22 retary, to utilize the applicable model reporting statement
23 for purposes of complying with requirements of such sub-
24 sections.

1 “(e) **TRANSPARENCY OF INFORMATION FILED.**—The
 2 Secretary shall create and maintain a public website, with
 3 searchable capabilities, for purposes of posting the infor-
 4 mation received by the Secretary pursuant to subsections
 5 (a) and (b). Any such information received by the Sec-
 6 retary (including any updates to such information received
 7 by the Secretary) shall be posted on the website not later
 8 than 60 days after receipt and shall not be treated as re-
 9 turn information for purposes of this title.”.

10 (c) **CLERICAL AMENDMENTS.**—

11 (1) The table of sections for subpart B of part
 12 IV of subchapter B of chapter 1 of such Code is
 13 amended by adding at the end the following new
 14 item:

“Sec. 149A. Reporting with respect to State or local government employee pen-
 sion benefit plans.”.

15 (2) The table of sections for chapter 43 of such
 16 Code is amended by adding at the end the following
 17 new item:

“Sec. 4980J. Failure of State or local government employee pension benefit
 plans to meet reporting requirements.”.

18 **SEC. 4. GENERAL PROVISIONS AND RULES OF CONSTRUC-**
 19 **TION.**

20 (a) **LIMITATIONS ON FEDERAL RESPONSIBILITIES**
 21 **RELATING TO PLAN OBLIGATIONS AND LIABILITIES.**—
 22 The United States shall not be liable for any obligation
 23 related to any current or future shortfall in any State or

1 local government employee pension plan. Nothing in this
2 Act (or any amendment made by this Act) or any other
3 provision of law shall be construed to provide Federal Gov-
4 ernment funds to diminish or meet any current or future
5 shortfall in, or obligation of, any State or local government
6 employee pension plan. The preceding sentence shall also
7 apply to the Federal Reserve.

8 (b) NO FEDERAL FUNDING STANDARDS.—Nothing
9 in this Act (or any amendment made by this Act) shall
10 be construed to alter existing funding standards for State
11 or local government employee pension plans or to require
12 Federal funding standards for such plans.

13 (c) DEFINITIONS.—Terms used in this section which
14 are also used in section 4980J of the Internal Revenue
15 Code of 1986 shall have the same meaning as when used
16 in such section.

○

112TH CONGRESS
1ST SESSION

H. R. 567

To amend the Internal Revenue Code of 1986 to provide for reporting and disclosure by State and local public employee retirement pension plans.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 9, 2011

Mr. NUNES (for himself, Mr. RYAN of Wisconsin, Mr. ISSA, Mr. SMITH of Texas, Mr. HERGER, Mr. BRADY of Texas, Mr. LEE of New York, Mr. GARRETT, Mr. CALVERT, Mr. MCCLINTOCK, Mr. CHAFFETZ, Mr. RIBBLE, Mr. FLORES, Mr. MCHENRY, Mr. MACK, Mr. GOSAR, Mr. LABRADOR, Mr. ROSS of Florida, Mr. SENSENBRENNER, Mrs. MCMORRIS RODGERS, Mrs. MYRICK, Mr. DUNCAN of South Carolina, Mr. ROHRABACHER, Mr. GALLEGLY, Mr. MCCOTTER, Mr. JONES, Mr. COBLE, Mr. SCALISE, Mr. BARTLETT, Mr. MCKINLEY, Mr. ROONEY, Mr. POSEY, Mr. DUNCAN of Tennessee, Mrs. BLACKBURN, Mr. NUGENT, Mr. COFFMAN of Colorado, Mr. LAMBORN, Mrs. BACHMANN, and Mr. WESTMORELAND) introduced the following bill; which was referred to the Committee on Ways and Means

A BILL

To amend the Internal Revenue Code of 1986 to provide for reporting and disclosure by State and local public employee retirement pension plans.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Public Employee Pen-
5 sion Transparency Act”.

1 **SEC. 2. FINDINGS.**

2 The Congress finds the following:

3 (1) Pursuant to clauses 1 and 3 of section 8 of
4 article I of the Constitution of the United States,
5 the Congress has the authority to condition the con-
6 tinuation of certain specified Federal tax benefits
7 upon State or local government employee pension
8 benefit plans provision of meaningful disclosure
9 under section 4980J of the Internal Revenue Code
10 of 1986, as added by this Act.

11 (2) State or local government employee pension
12 benefit plans have promised pension benefits to ap-
13 proximately 20 million Americans who are active em-
14 ployees of these entities. An additional 7 million re-
15 tirees and their dependents currently receive benefits
16 from State or local government employee pension
17 benefit plans. The interests of participants in many
18 of such plans are in the nature of property rights
19 under State law.

20 (3) State or local government employee pension
21 benefit plans are substantially facilitated by the fa-
22 vorable tax treatment of participants and bene-
23 ficiaries, investment earnings, and employee con-
24 tributions with respect to such plans provided by the
25 Federal Government under the Internal Revenue
26 Code of 1986.

1 (4) The investment of State or local govern-
2 ment employee pension benefit plan assets, the dis-
3 tribution of benefits under such plans, and other re-
4 lated financial activities are facilitated through the
5 use of instrumentalities of, and substantially affect,
6 interstate commerce. These activities, which are
7 interstate in nature and have a substantial impact
8 on the national economy, affect capital formation,
9 regional growth and decline, the national markets
10 for insurance, and the markets for securities and the
11 trading of securities of State and local governments.

12 (5) The financial status of State or local gov-
13 ernment employee pension benefit plans also has a
14 direct impact on the national markets for insurance
15 and trading of securities of State and local govern-
16 ments.

17 (6) State or local government employee pension
18 benefit plans additionally have a substantial impact
19 on interstate commerce as a consequence of the
20 interstate movement of participants.

21 (7) State or local government employee pension
22 benefit plans are becoming a large financial burden
23 on certain State and local governments and have al-
24 ready resulted in tax increases and the reduction of
25 services.

1 (8) In fact, a recent study published in the
2 Journal of Economic Perspectives found that the
3 present value of the already-promised pension liabil-
4 ities of the 50 States amount to \$5.17 trillion and
5 that these pension plans are unfunded by \$3.23 tril-
6 lion. Another study determined that the total un-
7 funded liability for all municipal plans in the United
8 States is \$574 billion.

9 (9) Some economists and observers have stated
10 that the extent to which State or local government
11 employee pension benefit plans are underfunded is
12 obscured by governmental accounting rules and
13 practices, particularly as they relate to the valuation
14 of plan assets and liabilities. This results in a
15 misstatement of the value of plan assets and an un-
16 derstatement of plan liabilities, a situation that
17 poses a significant threat to the soundness of State
18 and local budgets.

19 (10) There currently is a lack of meaningful
20 disclosure regarding the value of State or local gov-
21 ernment employee pension benefit plan assets and li-
22 abilities. This lack of meaningful disclosure poses a
23 direct and serious threat to the financial stability of
24 such plans and their sponsoring governments, im-
25 pairs the ability of State and local government tax-

1 payers and officials to understand the financial obli-
2 gations of their government, and reduces the likeli-
3 hood that State and local government processes will
4 be effective in assuring the prudent management of
5 their plans. The status quo also constitutes a serious
6 threat to the future economic health of the Nation
7 and places an undue burden upon State and local
8 government taxpayers, who will be called upon to
9 fully fund existing, and future, pension promises.

10 (11) State or local government employee pen-
11 sion benefit plans are affected with a national public
12 interest and meaningful disclosure of the value of
13 their assets and liabilities is necessary and desirable
14 in order to adequately protect plan participants and
15 their beneficiaries and the general public. Meaning-
16 ful disclosure would also further efforts to provide
17 for the general welfare and the free flow of com-
18 merce.

19 **SEC. 3. REPORTING OF INFORMATION WITH RESPECT TO**
20 **STATE OR LOCAL GOVERNMENT EMPLOYEE**
21 **PENSION BENEFIT PLANS TREATED AS A TAX**
22 **EXEMPTION, ETC., REQUIREMENT FOR STATE**
23 **AND LOCAL BONDS.**

24 (a) IN GENERAL.—Subpart B of part IV of sub-
25 chapter B of chapter 1 of the Internal Revenue Code of

1 1986 (relating to requirements applicable to all State and
2 local bonds) is amended by adding at the end the following
3 new section:

4 **“SEC. 149A. REPORTING WITH RESPECT TO STATE OR**
5 **LOCAL GOVERNMENT EMPLOYEE PENSION**
6 **BENEFIT PLANS.**

7 “(a) IN GENERAL.—In the case of a failure to satisfy
8 any requirement of subsection (a) or (b) of section 4980J
9 (relating to failure of State or local government employee
10 pension benefit plans to meet reporting requirements) with
11 respect to any plan maintained with respect to employees
12 of one or more States or political subdivisions of one or
13 more States, no specified Federal tax benefit shall be al-
14 lowed or made with respect to any specified bond issued
15 by any such State or political subdivision (or by any bond-
16 ing authority acting on behalf, or for the benefit, of such
17 State or political subdivision) during the noncompliance
18 period.

19 “(b) NONCOMPLIANCE PERIOD.—For purposes of
20 this section, the term ‘noncompliance period’ means, with
21 respect to any State or political subdivision in connection
22 with any failure, the period beginning on the date that
23 the Secretary notifies such State or political subdivision
24 of such failure and ending on the date that such failure
25 is cured (as determined by the Secretary).

1 “(c) SPECIFIED BOND.—For purposes of this section,
2 the term ‘specified bond’ means—

3 “(1) any State or local bond within the meaning
4 of section 103,

5 “(2) any qualified tax credit bond within the
6 meaning of section 54A, and

7 “(3) any build America bond within the mean-
8 ing of section 54AA.

9 “(d) SPECIFIED FEDERAL TAX BENEFIT.—For pur-
10 poses of this section, the term ‘specified Federal tax ben-
11 efit’ means—

12 “(1) any exemption from gross income allowed
13 under section 103 (relating to interest on State and
14 local bonds),

15 “(2) any credit allowed under section 54A (re-
16 lating to credit to holders of qualified tax credit
17 bonds),

18 “(3) any credit allowed under section 54AA (re-
19 lating to build America bonds), and

20 “(4) any credit or payment allowed or made
21 under section 6431 (relating to credit for qualified
22 bonds allowed to issuer).”.

23 (b) REPORTING REQUIREMENTS.—Chapter 43 of
24 such Code is amended by adding at the end the following
25 new section:

1 **“SEC. 4980J. FAILURE OF STATE OR LOCAL GOVERNMENT**
2 **EMPLOYEE PENSION BENEFIT PLANS TO**
3 **MEET REPORTING REQUIREMENTS.**

4 “(a) ANNUAL REPORT.—For purposes of section
5 149A, the requirements of this subsection are as follows:

6 “(1) IN GENERAL.—The plan sponsor of a
7 State or local government employee pension benefit
8 plan shall file with the Secretary, in such form and
9 manner as shall be prescribed by the Secretary, a re-
10 port for each plan year beginning on or after Janu-
11 ary 1, 2011, setting forth the following information
12 with respect to the plan, as determined by the plan
13 sponsor as of the end of such plan year:

14 “(A) A schedule of funding status, which
15 shall include a statement as to the current li-
16 ability of the plan, the amount of plan assets
17 available to meet that liability, the amount of
18 the net unfunded liability (if any), and the
19 funding percentage of the plan.

20 “(B) A schedule of contributions by the
21 plan sponsor for the plan year, indicating which
22 are or are not taken into account under sub-
23 paragraph (A).

24 “(C) Alternative projections which shall be
25 specified in regulations of the Secretary for
26 each of the next 20 plan years following the

1 plan year relating to the amount of annual con-
2 tributions, the fair market value of plan assets,
3 current liability, the funding percentage, and
4 such other matters as the Secretary may specify
5 in such regulations, together with a statement
6 of the assumptions and methods used in con-
7 nection with such projections, including as-
8 sumptions related to funding policy, plan
9 changes, future workforce projections, future
10 investment returns, and such other matters as
11 the Secretary may specify in such regulations.
12 The Secretary shall specify in such regulations
13 the projection assumptions and methods to be
14 used as necessary to achieve comparability
15 across plans.

16 “(D) A statement of the actuarial assump-
17 tions used for the plan year, including the rate
18 of return on investment of plan assets and as-
19 sumptions as to such other matters as the Sec-
20 retary may prescribe by regulation.

21 “(E) A statement of the number of partici-
22 pants who are each of the following—

23 “(i) those who are retired or sepa-
24 rated from service and are receiving bene-
25 fits,

1 “(ii) those who are retired or sepa-
2 rated and are entitled to future benefits,
3 and

4 “(iii) those who are active under the
5 plan.

6 “(F) A statement of the plan’s investment
7 returns, including the rate of return, for the
8 plan year and the 5 preceding plan years.

9 “(G) A statement of the degree to which,
10 and manner in which, the plan sponsor expects
11 to eliminate any unfunded current liability that
12 may exist for the plan year and the extent to
13 which the plan sponsor has followed the plan’s
14 funding policy for each of the preceding 5 plan
15 years. The Secretary shall prescribe by regula-
16 tion the specific criteria to be used for meeting
17 the requirements of this paragraph.

18 “(H) A statement of the amount of pen-
19 sion obligation bonds outstanding.

20 “(2) TIMING OF REPORT.—The plan sponsor of
21 a State or local government employee pension ben-
22 efit plan shall make the filing required under para-
23 graph (1) for each plan year not later than 210 days
24 after the end of such plan year (or within such time

1 as may be required by regulations prescribed by the
2 Secretary in order to reduce duplicative filing).

3 “(b) ADDITIONAL REPORTING REQUIREMENTS.—

4 For purposes of section 149A, the requirements of this
5 subsection are as follows:

6 “(1) SUPPLEMENTARY REPORTS.—In any case
7 in which, in determining the information filed in the
8 annual report for a plan year under subsection (a)—

9 “(A) the value of plan assets is determined
10 using a standard other than fair market value,
11 or

12 “(B) the interest rate or rates used to de-
13 termine the value of liabilities or as the dis-
14 count value for liabilities are not the interest
15 rates described in paragraph (3),

16 the plan sponsor shall include in the annual report
17 filed for such plan year pursuant to subsection (a)
18 the supplementary report for such plan year de-
19 scribed in paragraph (2) of this subsection.

20 “(2) USE OF PRESCRIBED VALUATION METHOD
21 AND INTEREST RATES.—A supplementary report for
22 a plan year filed for a plan year pursuant to this
23 subsection shall include the information specified as
24 required in the annual report under subparagraphs
25 (A), (C), (F), and (G) of subsection (a)(1), deter-

1 mined as of the end of such plan year by valuing
2 plan assets at fair market value and by using the in-
3 terest rates described in paragraph (3) to value li-
4 abilities and as the discount value for liabilities.

5 “(3) INTEREST RATES BASED ON U.S. TREAS-
6 URY OBLIGATION YIELD CURVE RATE.—

7 “(A) IN GENERAL.—The interest rates de-
8 scribed in this subsection are—

9 “(i) in the case of benefits reasonably
10 determined to be payable during the 5-year
11 period beginning on the first day of the
12 plan year, the first segment rate with re-
13 spect to the applicable month,

14 “(ii) in the case of benefits reasonably
15 determined to be payable during the 15-
16 year period beginning at the end of the pe-
17 riod described in subparagraph (A), the
18 second segment rate with respect to the
19 applicable month, and

20 “(iii) in the case of benefits reason-
21 ably determined to be payable after the pe-
22 riod described in clause (ii), the third seg-
23 ment rate with respect to the applicable
24 month.

1 “(B) SEGMENT RATES.—For purposes of
2 this paragraph—

3 “(i) FIRST SEGMENT RATE.—The
4 term ‘first segment rate’ means, with re-
5 spect to any month, the single rate of in-
6 terest which shall be determined by the
7 Secretary for such month on the basis of
8 the U.S. Treasury obligation yield curve
9 for such month, taking into account only
10 that portion of such yield curve which is
11 based on obligations maturing during the
12 5-year period commencing with such
13 month.

14 “(ii) SECOND SEGMENT RATE.—The
15 term ‘second segment rate’ means, with re-
16 spect to any month, the single rate of in-
17 terest which shall be determined by the
18 Secretary for such month on the basis of
19 the U.S. Treasury obligation yield curve
20 for such month, taking into account only
21 that portion of such yield curve which is
22 based on obligations maturing during the
23 15-year period beginning at the end of the
24 period described in clause (i).

1 “(iii) THIRD SEGMENT RATE.—The
2 term ‘third segment rate’ means, with re-
3 spect to any month, the single rate of in-
4 terest which shall be determined by the
5 Secretary for such month on the basis of
6 the U.S. Treasury obligation yield curve
7 for such month, taking into account only
8 that portion of such yield curve which is
9 based on obligations maturing during peri-
10 ods beginning after the period described in
11 clause (ii).

12 “(C) U.S. TREASURY OBLIGATION YIELD
13 CURVE.—For purposes of this subsection, the
14 term ‘U.S. Treasury obligation yield curve’
15 means, with respect to any month, a yield curve
16 which shall be prescribed by the Secretary for
17 such month and which reflects the average, for
18 the 24-month period ending with the month
19 preceding such month, of monthly yields on in-
20 terest-bearing obligations of the United States.

21 “(c) DEFINITIONS.—For purposes of this section—

22 “(1) STATE OR LOCAL GOVERNMENT EM-
23 PLOYEE PENSION BENEFIT PLAN.—The terms ‘State
24 or local government employee pension benefit plan’
25 and ‘plan’ mean any plan, fund, or program, other

1 than a defined contribution plan (within the mean-
2 ing of section 414(i)), which was heretofore or is
3 hereafter established or maintained, in whole or in
4 part, by a State, a political subdivision of a State,
5 or any agency or instrumentality of a State or polit-
6 ical subdivision of a State, to the extent that by its
7 express terms or as a result of surrounding cir-
8 cumstances such plan, fund, or program—

9 “(A) provides retirement income to em-
10 ployees, or

11 “(B) results in a deferral of income by em-
12 ployees for periods extending to the termination
13 of covered employment or beyond, regardless of
14 the method of calculating the contributions
15 made to the plan, the method of calculating the
16 benefits under the plan, or the method of dis-
17 tributing benefits from the plan.

18 “(2) FUNDING PERCENTAGE.—The term ‘fund-
19 ing percentage’ for a plan year means the ratio (ex-
20 pressed as a percentage) which—

21 “(A) the value of plan assets as of the end
22 of the plan year bears to

23 “(B) the current liability of the plan for
24 the plan year.

1 “(3) CURRENT LIABILITY.—The term ‘current
2 liability’ of a plan for a plan year means the present
3 value of all benefits accrued or earned under the
4 plan as of the end of the plan year.

5 “(4) PLAN SPONSOR.—The term ‘plan sponsor’
6 means, in connection with a State or local govern-
7 ment employee pension benefit plan, the State, polit-
8 ical subdivision of a State, or agency or instrumen-
9 tality of a State or a political subdivision of a State
10 which establishes or maintains the plan.

11 “(5) PARTICIPANT.—

12 “(A) IN GENERAL.—The term ‘participant’
13 means, in connection with a State or local gov-
14 ernment employee pension benefit plan, an indi-
15 vidual—

16 “(i) who is an employee or former em-
17 ployee of a State, political subdivision of a
18 State, or agency or instrumentality of a
19 State or a political subdivision of a State
20 which is the plan sponsor of such plan, and

21 “(ii) who is or may become eligible to
22 receive a benefit of any type from such
23 plan or whose beneficiaries may be eligible
24 to receive any such benefit.

1 “(B) BENEFICIARY.—The term ‘bene-
2 ficiary’ means a person designated by a partici-
3 pant, or by the terms of the plan, who is or
4 may become entitled to a benefit thereunder.

5 “(6) PLAN YEAR.—The term ‘plan year’ means,
6 in connection with a plan, the calendar or fiscal year
7 on which the records of the plan are kept.

8 “(7) STATE.—The term ‘State’ includes any
9 State of the United States, the District of Columbia,
10 the Commonwealth of Puerto Rico, the Virgin Is-
11 lands, American Samoa, Guam, and the Common-
12 wealth of the Northern Mariana Islands.

13 “(8) FAIR MARKET VALUE.—The term ‘fair
14 market value’ has the meaning of such term under
15 section 430(g)(3)(A) (without regard to section
16 430(g)(3)(B)).

17 “(d) MODEL REPORTING STATEMENT.—The Sec-
18 retary shall develop model reporting statements for pur-
19 poses of subsections (a) and (b). Plan sponsors of State
20 or local government employee pension plans may elect, in
21 such form and manner as shall be prescribed by the Sec-
22 retary, to utilize the applicable model reporting statement
23 for purposes of complying with requirements of such sub-
24 sections.

1 “(e) **TRANSPARENCY OF INFORMATION FILED.**—The
 2 Secretary shall create and maintain a public Web site,
 3 with searchable capabilities, for purposes of posting the
 4 information received by the Secretary pursuant to sub-
 5 sections (a) and (b). Any such information received by the
 6 Secretary (including any updates to such information re-
 7 ceived by the Secretary) shall be posted on the Web site
 8 not later than 60 days after receipt and shall not be treat-
 9 ed as return information for purposes of this title.”.

10 (c) **CLERICAL AMENDMENTS.**—

11 (1) The table of sections for subpart B of part
 12 IV of subchapter B of chapter 1 of such Code is
 13 amended by adding at the end the following new
 14 item:

“Sec. 149A. Reporting with respect to State or local government employee pen-
 sion benefit plans.”.

15 (2) The table of sections for chapter 43 of such
 16 Code is amended by adding at the end the following
 17 new item:

“Sec. 4980J. Failure of State or local government employee pension benefit
 plans to meet reporting requirements.”.

18 **SEC. 4. GENERAL PROVISIONS AND RULES OF CONSTRUC-**
 19 **TION.**

20 (a) **LIMITATIONS ON FEDERAL RESPONSIBILITIES**
 21 **RELATING TO PLAN OBLIGATIONS AND LIABILITIES.**—
 22 The United States shall not be liable for any obligation
 23 related to any current or future shortfall in any State or

1 local government employee pension plan. Nothing in this
2 Act (or any amendment made by this Act) or any other
3 provision of law shall be construed to provide Federal Gov-
4 ernment funds to diminish or meet any current or future
5 shortfall in, or obligation of, any State or local government
6 employee pension plan. The preceding sentence shall also
7 apply to the Federal Reserve.

8 (b) NO FEDERAL FUNDING STANDARDS.—Nothing
9 in this Act (or any amendment made by this Act) shall
10 be construed to alter existing funding standards for State
11 or local government employee pension plans or to require
12 Federal funding standards for such plans.

13 (c) DEFINITIONS.—Terms used in this section which
14 are also used in section 4980J of the Internal Revenue
15 Code of 1986 shall have the same meaning as when used
16 in such section.

○

March 15, 2011

PROPOSED PUBLIC EMPLOYEE PENSION REPORTING REQUIREMENTS ARE UNNECESSARY

Rules Would Create Confusion and Could Roil Markets

By Iris J. Lav

In February, Congressmen Devin Nunes and Darrell Issa (both California Republicans) and Paul Ryan (R-Wis) introduced legislation (H.R. 567) to require states and local governments to report their pension liabilities to the federal government using what is known as a “riskless rate” — an interest rate tied to the Treasury bond rate — to determine those liabilities.¹ Any state or local government not complying with this requirement would face a penalty of great severity — it would lose the ability to issue tax exempt bonds, which states and localities rely upon to finance infrastructure construction and related purposes.

There is clearly a need to standardize state and local pension reporting and make it more transparent. Extensive work on these matters by an expert, non-political board that enjoys respect in financial markets — the Governmental Accounting Standards Board — is now nearing completion. GASB is on track to issue new standards next year for state and local government reporting on the financial status of their pension funds.

The Nunes bill, however, would effectively short-circuit and override the GASB process by issuing a federal edict on how pension funds are to report liabilities. It would be unsound policy to substitute heavy-handed and unnecessary federal intrusion (which seems designed in part to advance ideological goals, as explained below) for the GASB standards and the financial market discipline that induces state and local governments to comply with those standards.

There are a number of other, related problems with the Nunes proposal, as well, including:

- It could sow public confusion, as it would likely lead the public and many policymakers to believe that the amounts that states and localities need to deposit in their pension plans each year are substantially larger than the amounts actually needed. Misunderstanding of the level of contributions required could lead to excessive cuts in *other* parts of state budgets (such as education) and/or greater-than-needed tax increases in order to free up more room in state budgets for the greatly increased pension contributions; it also could generate pressure to end

¹ The legislation is called “Public Employee Pension Transparency Act.” An identical bill S.347 has been introduced in the Senate by Senator Richard Burr.

defined-benefit pension plans.

- It would fail to accomplish its stated objective of allowing observers to compare the funding status of pensions on an “apples-to-apples” (or standardized) basis because it would set standards for only two of the array of variables that are used to calculate pension-fund liabilities.
- A new federal bureaucracy would have to be created to gather, process, and verify the information for the nation’s 2,550 state and local pension plans and to apply and enforce any penalties that would have to be applied under the legislation. The new bureaucracy would be created at a time when the federal government is trying to cut costs.
- The legislation could unnecessarily spook the bond markets, leading to higher borrowing costs for states and localities.

This analysis first explains the underlying issues and why the legislation would likely sow confusion and fail to enable meaningful comparison of different pension plans. It then examines the GASB process that represents a far superior approach. Finally, it looks at the bill’s impact in necessitating a new federal bureaucracy and its potential to rattle bond markets.

The Legislation Would Sow Public Confusion

A debate has begun over what assumptions public pension plans should use for their “discount rate” — that is, the interest rate they use to translate future benefit obligations into today’s dollars.² The decision on what discount rate assumption to use affects the estimates of the future liabilities that pension funds face, and it may also affect the level of required annual contributions by state and local governments to the pension funds.

The “findings” section of the Nunes bill declares, as though it were a clear and agreed-upon fact, that state pension plans have unfunded liabilities of \$3.23 trillion. In reality, there is considerable debate and disagreement about the best way to measure unfunded liabilities, a matter for which there is no simple right or wrong answer, since estimates of liabilities depend on the assumptions that are employed. The \$3.23 trillion estimate of unfunded liabilities which the Nunes bill would enshrine in law derives from calculating liabilities using what is known as the “riskless discount rate,” essentially the rate for U.S. Treasury obligations. In contrast, standard analyses based on accepted state and local accounting rules — which calculate liabilities using the historical average return on pension plans’ assets, which is higher because pensions diversify their investments rather than investing solely in bonds — put the unfunded liability at about a quarter of that amount, a more manageable (though still concerning) \$700 billion.

Economists generally support use of the riskless rate in valuing state and local pension liabilities because the constitutions and laws of most states prevent major changes in pension promises to current employees or retirees; they argue that definite promises should be valued as if invested in financial instruments with a guaranteed rate of return, like Treasury bonds. State and local pension

² For an extended discussion of this issue, see Iris J. Lav and Elizabeth McNichol, *Misunderstandings Regarding State Debt, Pensions, and Retiree Health Create Unnecessary Alarm*, Center on Budget and Policy Priorities, January 20, 2011. <http://www.cbpp.org/cms/index.cfm?fa=view&id=3372>

funds, however, historically have invested in a diversified market basket of private securities and received average rates of return much higher than the riskless rate – 8 percent over the past two decades. (A “riskless rate” would be about 4 percent or possibly less.) It also should be noted that economists are *not* arguing that state and local pension funds should change their investment practices, liquidate their equity portfolios, and invest solely in bonds.

A key point to understand is that the issues of: 1) how states and localities should *value* their pension liabilities; and 2) how much they should *contribute* to their pension funds each year to meet their pension obligations are two separate issues, although they obviously are related. The estimate of more than \$3 trillion in unfunded liabilities that results from use of the “riskless rate” does *not* mean states and localities should have to contribute that amount to their pension funds, since the pension funds very likely will earn higher rates of return over time than the Treasury bond rate — and that, in turn, means states can achieve pension fund balances adequate to meet future obligations without adding the full \$3 trillion to the funds. In fact, two of the leading economists who advocate valuing state pension fund assets at the riskless rate have observed, “...the question of optimal funding levels...is entirely separate from the valuation question.”³

Given this complex situation, there is risk that a federal rule that *mandates* valuation on the basis of the “riskless” rate would sow confusion between the unfunded liability valuation and the amounts necessary for state and local government to contribute to the plans. The public is unlikely to be able to distinguish between the valuation required under the legislation and the required annual contribution levels, especially if the large unfunded liability numbers derived under the legislation’s reporting requirements are widely publicized. This may lead some policymakers to conclude that the levels of required contributions are unaffordable and the pension plans no longer viable when that is not the case.

More specifically, if states and localities are pressured to increase their annual pension contributions to meet the much larger contribution amounts that would be required if the “riskless” discount rate were used mechanically to calculate the contribution levels, any of several deleterious effects could result. States could end up cutting education or other priority investments in order to free up room in their budgets for pension contribution levels that exceed the amounts needed to cover future pension liabilities. Or, states could raise taxes more than is needed. Moreover, the overfunding of pension plans that ultimately would result could lead to demands for increased pension benefits that would not represent a sound use of resources.

Alternatively, if states and localities are pressured to raise their pension contributions to the levels that would be needed if pension funds actually invested solely in bonds, that could induce more states to abandon defined benefit pension plans altogether. That appears to be one of the goals of some of the bill’s sponsors. Commenting on an identical bill introduced in the last Congress, the *Wall Street Journal* said, “Their bill would encourage governments to switch to defined-contribution plans by revealing the true magnitude of their unfunded liabilities.”⁴ Rep. Nunes also told a group of California government officials, “So what this will only set up, what the folks in the private sector

³ Robert Novy-Marx and Joshua Rauh, “Public Pension Promises: How Big Are They and What Are They Worth?” *Journal of Finance*, forthcoming (posted October 8, 2010 on Social Science Research Network), p. 5.

⁴ “Public Pension Hygiene Act,” *Wall Street Journal*, January 22, 2011.

have figured out a long time ago, was that you have to get away from the defined benefit plan (pensions) and somehow get to a defined contribution (401(k)-style plan).”⁵

To be sure, many states and localities do need to increase the amount of funding they deposit in their pension funds to address their unfunded liabilities. But they do not need the massive increases in contributions that would be required if pension funds were to invest solely in bonds and to receive the bond rate of return.

Legislation Would Not Standardize Pension Reporting

Congressman Nunes has said that an important purpose of his bill is to allow someone to “...compare the roughly 2,500 public employee pensions against each other to know which plan is better funded compared to other plans.”⁶ The legislation, however, would not accomplish that objective.

The bill requires states and localities to provide a variety of information about the funding status of their pension plans, presented in the normal ways they make those calculations. These calculations generally are made by states and localities based on the guidance provided by the Governmental Accounting Standards Board. GASB’s current standards (which, as described below, are in the process of being changed) allow a range of variation on a number of dimensions of pension accounting. Variables affecting plan valuation and the current value of unfunded liabilities that may differ from plan to plan include the liability accrual method (with GASB currently allowing seven different methods, of which three are in common use), the assumptions about wage inflation and (if there is an automatic COLA) price inflation, the valuation of assets, and the interest rate (i.e., the assumed rate of earnings that the pension fund earns on its assets). These types of variations make it difficult to compare the funding status of one plan to another.

The Nunes bill specifies that each state and locality must include a supplementary report in which plan assets are valued using fair market value and the interest rate is the rate on Treasury bonds. But standardizing just these two dimensions of pension funding calculations will not create comparability among the reports of different state and local governments, because other elements of the calculation that result in large differences across plans will continue to be reported on different bases.

For example, different accrual methods yield different estimates of funding status with different interpretations. It is also the case that a state with an automatic COLA that assumes lower price inflation in the future will look better funded than a similar plan that assumes higher inflation. Moreover, considering the size of unfunded liabilities alone does not give a full picture of the status of a state’s pension fund. Also important is the annual pension expense relative to some measure of affordability. This can differ with the number of years over which unfunded liabilities are amortized. For example, Maine amortizes unfunded liabilities over 10 future years, while Illinois amortizes over 40 years. Other states fall in between. For any given amount of unfunded liabilities, a state with a

⁵ Ed Mendel, “Pension Debt Bill: New Drive Toward 401(k)s,” *Calpensions*, posted February 21, 2011. <http://calpensions.com/2011/02/21/pension-debt-bill-new-drive-toward-401ks/>

⁶ Diane Rehm Show, February 23, 2011.

shorter amortization period will look as though it has higher annual pension expenses relative to its budget or economy than a state that uses a longer period.

As described below, the proposed revisions in the Governmental Accounting Standards Board's pension guidance for state and local governments attempt to standardize *all* of these dimensions to create comparability among plans.

The Legislation Would Short-Circuit and Conflict with the GASB Process

For the past four years, the Governmental Accounting Standards Board — which sets standards for financial accounting for governments, just as the Financial Accounting Standards Board (FASB) does for private sector businesses — has been conducting extensive research and consultation with well over 100 stakeholders, including public hearings, to develop new pension financial reporting standards. The standards are expected to be promulgated next year. While GASB has no authority to *require* states and localities to follow its standards, bond raters and financial analysts generally look askance at governmental entities that do not comport with the standards. Thus, GASB standards typically become the *de facto* financial accounting rules for state and local governments, because of the discipline of the financial markets.⁷

The new GASB standards have been issued in draft form. Assuming that the final standards will be similar to the most recent GASB draft, the new standards will provide for many fewer choices of methods and move state and local governments to issue annual statements of the financial position of their pension funds that are comparable to one another. Unlike the Nunes bill, the forthcoming GASB standard addresses a wide array of areas of pension financial reporting in its effort to achieve accuracy and much greater uniformity.

For example, the draft of the GASB standard requires all pension funds to report on the same liability accrual basis, known as the “entry age” method. This would assure that the reported funding status (i.e., the percentage of liabilities for which assets are available) is comparable from plan to plan.⁸ The GASB standard also would eliminate most of the discrepancy in the number of years over which unfunded liabilities are amortized. The Nunes bill, by contrast, does not address differences in accrual methods or amortization periods.

In addition, while the Nunes bill requires use of the interest rate for Treasury bonds to determine the funding status of pension funds, the draft GASB standard explains that the liability amount that results from using the “riskless rate” to calculate fund liabilities does *not* reflect the amount that state

⁷ The GASB revised guidance applies only to accounting and financial reporting; it would not necessarily apply to the calculations used to determine pension fund contributions. Currently, however, the GASB rules generally are used for both purposes, such as the determination of the amount that should be contributed each year (known as the Annual Required Contribution), and the new rules are likely also to be used for both purposes in most instances.

⁸ The entry age actuarial method calculates the present value of projected benefits payments discounted to the employee's entry age and then calculates a level amount — usually a percentage of payroll — that should be contributed each year on behalf of that employee, given projected investment earnings. This method values pension benefits relative to the employee's salary each year. It also eliminates (or minimizes) the discrepancy in the number of years over which unfunded liabilities are amortized, since a calculation would be made for each active plan participant that depends on the number of years left in his or her working career.

and local governments need to deposit in their pension funds.⁹ To estimate the amount of pension fund assets actually expected to be available to finance pension payments, the draft GASB standard calls for use of the actual expected rate of return, because it better reflects the level of contributions that will be needed. The GASB draft does require use of a lower interest rate for projecting benefit payments expected to have to be made after the projected point at which a plan's assets are expected to be depleted. For the portion of future liabilities for which current assets or expected contributions and associated earnings cannot be identified, the GASB draft standard uses an interest rate derived from an index rate for state and local governmental bonds of high quality.

Accordingly, the *overall* rate that the GASB draft would use to estimate the level of contributions that state and local governments need to make to their pension funds would be based on a *blend* of the expected rate of return on a fund's existing and expected assets *and* the rate of return on high-quality municipal bonds (which would be applied to the additional funding that will be needed). The precise blend would depend on various factors related to the funding status of the pension fund.

A large amount of analysis and thought has gone into the development of the new GASB standards. The process of developing these standards has been one into which all stakeholders and interested parties have had an opportunity to provide input and analysis, and the GASB Board has spent considerable time scrutinizing these submissions and various other analyses. When the final standard is issued, it is likely to have strong compliance.¹⁰

The Legislation Would Create A New Bureaucracy

There are 2,550 distinct state and local pension plans in the country, as Rep. Nunes has noted.¹¹ Each state or locality provides information about its plan. The federal government does not collect or compile this information.

As a result, instituting the Nunes bill would necessitate creating a new bureaucracy within the Treasury Department to maintain information on active pension plans, collect relevant reports from state and local governments, assure the timeliness of those reports, check them for accuracy and for compliance with the terms of the legislation and the implementing regulations, communicate with the states and localities regarding any discrepancies, and enforce the penalties (described below) on states and localities that are out of compliance.

As noted above, it is financial analysts and the securities markets that enforce discipline on the pension reporting of states and localities. Once the new GASB standards are in place, the strong market incentives for compliance with those standards will assure that the reported financial status

⁹ The GASB draft said use of the riskless rate was not "...consistent with the view ... that the present value of projected benefit payments should reflect an expectation of the employer's projected sacrifice of resources, reduced by the expected return on investments."

¹⁰ Neither the author nor the Center on Budget and Policy Priorities are commenting here on the specifics of the proposed GASB standards.

¹¹ <http://www.census.gov/govs/retire/2008ret05a.html>

of pension plans is comparable across plans. This is a clear example of a situation in which the operation and discipline of markets is preferable to the imposition of federal regulations.

The Legislation Could Spook Bond Markets

The state and local bond markets have been volatile recently. In particular, the appearance on the television show *60 Minutes* by a financial analyst predicting 50 to 100 significant bond defaults this year — a claim later shown not to be supported by solid analysis — is thought to have played a major role in causing some investors to lose confidence in municipal bonds at the end of 2010 and beginning of 2011, resulting in a sizeable sell-off of those securities.¹² States and municipalities have had to offer higher interest rates to sell their bonds because of this loss of confidence, a situation that is only now slowly turning around.

The potential of large and confusing unfunded liability numbers appearing on a federal government website could have a similar affect on the bond market, especially since those numbers would not represent the amounts that states and localities actually need to contribute to their pension funds to cover their obligations. Not every financial analyst, bond trader, or investor understands the complexity of state and local pension financing and thus would know how to interpret these data. The legislation and the data it requires hold the potential to frighten potential investors unnecessarily and thereby result in higher interest costs for states and localities.

Penalty Could Have Unintended Consequences

The penalty for failure to comply with these reporting requirements would be the loss of a state's or municipality's ability to issue tax-exempt bonds. That would be a massive — and unprecedented — penalty that would render it virtually impossible for the state or local government in question to attract investors. While it is unlikely that matters would get to a point where such a penalty would actually be imposed on a state, such a development is not impossible. And it is conceivable, even if unlikely, that the penalty could be imposed as a result of legitimate differences of opinion between a city or state and employees of the Treasury Department over the best data to use in particular circumstances and reports.

States and localities issue tax-exempt bonds largely to finance infrastructure. The bonds allow them to build and maintain bridges and highways, build schools and other public buildings, and subsidize the building of low-income housing, to name some of the most common uses. The country has a large backlog of unmet infrastructure needs, and, over time, our deteriorating infrastructure will have a negative effect on economic growth and development. Threatening state and local governments' ability to support infrastructure to compel compliance with a federally-dictated reporting requirement would be excessive and inappropriate.

¹² See, for example, Max Abelson and Michael McDonald, "Whitney Municipal-Bond Apocalypse Short on Specific," Bloomberg News, February 1, 2001.

Conclusion

No state or locality has asked the federal government to “bail out” its pension plan, nor is any state likely to do so in the future. A number of states and localities clearly need to institute pension reforms. But they have the tools needed to restore their pension plans to an appropriate level of funding over time as markets and the economy improve.

Pension financial reporting standards are about to be overhauled as GASB completes its process with input from stakeholders and consideration of an array of issues related to pension financing and reporting. No useful purpose is served by arbitrarily imposing different federal standards before the GASB process is completed. Doing so would likely sow public confusion, require the creation of a new (and potentially intrusive) federal bureaucracy, and risk spooking the bond markets and threatening the ability of states and localities to invest in needed infrastructure improvements.