



Midterm Elections Shake Up Congressional Committees

At a recent reception on Capitol Hill, new members of Congress were identified by special ribbons on their badges. However, it was the expression on their faces that made them truly stand out in the crowded room—a mixture of hope, pride, determination, and angst. Such conflicting emotions make perfect sense, especially when you consider the high expectations they will be measured against as they officially step

onto the floors of the House and Senate chambers and into the history books a few weeks from now.

From doctors and lawyers to state legislators, professors, and even a former professional football player, they represent the largest group of newly elected members to enter the Senate since 1981 and will give House Republicans their largest majority since 1948.

Although the elections were, as predicted, a significant jolt for incumbents in general and Democrats in particular, it is not unusual for the president's party to take a hit in the midterm elections. The Democrats did manage to hold onto their majority in the Senate, which means that while their colleagues in the House may find that they exert little influence over passing legislation, Senate Democrats

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will have the opportunity to act as a roadblock to the Republican agenda.

To better understand the implications of the midterm elections for NCPERS and the public pension community, let's look at the anticipated leadership changes for some key committees.

On the Senate side, Sen. Tim Johnson (D-SD) will replace the retiring Sen. Christopher Dodd (D-CT) as chair of the powerful Senate Banking Committee. Johnson, who is more of a moderate than Dodd, is known for his strong support of local community banks. The biggest task for his committee in 2011 will be overseeing the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. With the bill calling for more than 200 new regulations and over 100 reports to Congress, this activity will account for a substantial amount of the committee's resources. Of particular note will be regulations governing the derivatives market, as well as other important regulations coming from the new Financial Stability Oversight Council, the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC).

The Senate Health Education Labor and Pensions (HELP) Committee's responsibilities encompass aging and retirement, including private pension plans. Sen. Tom Harkin (D-IA) will likely stay on as chair of this committee, supported by Sen. Barbara Mikulski (D-MD) as chair of the

Retirement and Aging Subcommittee. Sen. Mike Enzi (R-WY) will likely become the ranking Republican of the HELP committee.

The Senate Finance Committee concerns itself with matters relating to taxation and other revenue measures in general, as well as health programs under the Social Security Act, including Medicare and Medicaid. Sen. Max Baucus (D-MT) is expected to continue as chair, with Sen. Orrin Hatch (R-UT) stepping into the ranking Republican slot. Hatch would replace current ranking Republican Sen. Chuck Grassley (R-IA), whose term in this position has expired. Sen. John D. Rockefeller IV (D-WV) is expected to head both the Subcommittee on Health Care and the Subcommittee on Social Security, Pensions, and Family Policy.

On the House side, two leading candidates will take over the helm of the Financial Services Committee: current Ranking Member Spencer Bachus (R-AL) and Rep. Ed Royce (R-CA). Although Bachus would normally be the obvious choice, his popularity among party members has suffered as a result of his work with Democrats on the financial reform bill debate earlier this year. Other current committee members who are likely to be key players in defining the committee's agenda are Reps. Jeb Hensarling (R-TX) and Scott Garrett (R-NJ). Like its Senate Banking Committee counterpart, this committee is expected to spend significant resources on implementing Dodd-Frank. However, given Republican control of the House,

the committee may also actively seek to implement additional financial reform legislation, including efforts to pull back on some Dodd-Frank changes. Possible targets include defunding of the Consumer Financial Protection Bureau or a reorganization to make the bureau subject to existing banking regulators, as well as revoking or revising new powers granted in the law to manage systemically important institutions.

However, as noted earlier, these plans will need to survive the Democratic gauntlet in the Senate to succeed. Intransigence on the part of Senate Democrats may prove to be an even more significant roadblock given the short time before most provisions of the bill take effect in July 2011. Republicans will need to move any proposed legislation by then, because changes after the effective date would be significantly more difficult to achieve.

Another key House committee is Ways and Means, which has jurisdiction over taxation, including Social Security (though excluding Social Security Act healthcare provisions). Rep. Dave Camp (R-MI) currently serves as the ranking Republican and is expected to take over its leadership. Reps. Wally Herger (R-CA) and Sam Johnson (R-TX) currently serve as the ranking Republicans on the Health and Social Security Subcommittees, respectively, and will likely chair those subcommittees.

The House Committee on Education and Labor has jurisdiction over, among other areas, employment-related retirement security, including private

pensions. As with Ways and Means, the current ranking Republican, Rep. John Kline (R-MN), is expected to get the nod as chair. Rep. Tom Price (R-GA) will likely chair the Subcommittee on Health, Employment, Labor, and Pensions. On the pensions and employee benefits front, the outlook for bipartisanship appears stronger than on some other issues, given a history of successful bipartisan pension bills in prior Congresses. In addition, expect House Republicans to be more interested in finding ways to reduce administrative burdens on plan sponsors rather than on placing new restrictions on employer-sponsored plans.

NCPERS Legislative Agenda for the 112th Congress

As of this writing, when the 112th Congress convenes in January, there will be 97 new members in the House of Representatives and 16 in the Senate. In addition, in the House Republican majority, there will be 88 new members. A cultural sea change is about to hit Washington, and the public pension community needs to be prepared. NCPERS is working to refine its legislative and regulatory approach to the new political landscape. Our Legislative Conference this winter will provide a full briefing on the key issue areas and strategies we will pursue.

At the outset, we must prepare for introduction and consideration of the Public Employee Pension Transparency Act. This legislation is

currently being drafted by Congressman Devin Nunes (R-CA), who serves on the House Ways and Means Committee. The bill would create extensive annual reporting requirements on plan sponsors, including funding status, liabilities, net unfunded liabilities, contribution schedules and actuarial assumptions. The draft legislation would also require supplementary reports on plan valuations and liabilities based on the U.S. Treasury obligation yield curve rate. Failure to comply with the reporting requirements, which will be defined further by Treasury Department regulations, would result in the loss of certain federal tax benefits on bonds issued by the state or political subdivision.

We also must be prepared for a push by House Republicans into oversight of governmental plans. The scandal of Bell, California, still echoes, and the presumptive chair of the House Committee on Oversight and Government Reform, Congressman Darrell Issa, hails from the Golden State, where he read the headlines on a daily basis. Although oversight hearings are not likely to lead to a serious federal legislative proposal, they will be a public relations headache for governmental plans, and time and resources must be devoted to them. Congressional hearings may also lead to a heightened focus at the state and local levels on so-called pension reforms, which tend to result in lower defined benefit (DB) pension plans or a shift to deferred compensation (DC) plans.

On the offensive side, NCPERS is preparing to advocate (1) modifications to Internal Revenue Code (IRC) §72(t)(10) – the waiver of the 10 percent early withdrawal penalty for public safety employees; (2) an exemption for governmental pension plans from the Treasury Department’s regulations on normal retirement age; and (3) improvements to the HELPS provision.

Regarding the 72(t) modifications, NCPERS will seek passage of legislation to make three changes to the statute. The first change would ensure that plan participants who initiated a stream of payments before enactment of the Pension Protection Act of 2006 (PPA) would not be subject to the 10 percent penalty if they subsequently modify the amounts of the distributions. The impetus for this change is losing steam the farther we move from PPA enactment, because any participant who began a stream of payments prior to enactment is moving closer to age 59½, which will provide insulation from the penalty.

The second proposed 72(t) change is the current driving force for the legislation. The current statutory exemption is limited to distributions from DB plans; therefore, a distribution from a governmental 457(b) plan would not be eligible for the exemption. The problem occurs when plan participants are required to move their deferred retirement option plan (DROP) assets upon separation of

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service. At that point, many retirees will move the funds into a 457(b) plan and then subsequently take a distribution. The legislation that NCPERS is pursuing would ensure that distributions from a 457(b) plan made by a public safety employee would be eligible for the exemption.

The final 72(t) change is one of pure fairness – the inclusion of federal public safety employees in the waiver

of the 10 percent penalty. The current exemption is limited to public safety employees of state and local governments. For those who risk their lives for the public, it should not matter whether they are employed by a state or local government or by the federal government.

In 2007, the Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations that would define the term *normal retirement age*

(NRA) for all pension plans. The regulations provide that pension plans must have an age-based NRA. In the eyes of Treasury–IRS officials, *age* means number. In contrast, however, many public pension plans historically have defined eligibility for retirement as years of service. Still others have based retirement eligibility on a combination of years of service and age, which Treasury–IRS officials say would likewise be noncompliant.

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Executive Director's Corner

Hank H. Kim, Esq.
Executive Director
& Counsel

As a result of the midterm elections, numerous new faces will be seen in the halls of Congress beginning in January. Because so much of what gets accomplished on Capitol Hill does so as a result of relationships, we will need to get right to work introducing ourselves – and educating them – about our industry and our issues. The annual NCPERS Legislative Conference on January 30–February 1 will present a particularly golden opportunity for us to be among the first groups to lobby the new Congress.

We've set aside an entire day of the conference for congressional visits. Attendees will fan out across the Hill to meet one-on-one with their elected officials. I cannot emphasize enough the importance of these visits. By putting a "face" on issues affecting public pensions, we can help legislators understand our point of view in a much more personal way. Our messages also carry the added weight of coming directly from constituents, and I think it's safe to say that this new class of legislators has a very clear understanding of the importance of voter opinion.

The Legislative Conference is just the beginning of what promises to be a very busy year for NCPERS, which has

much work to be done. The media continue to sensationalize the pension underfunding issue, while the U.S. economic recovery has yet to take off. The change in control of the U.S. House of Representatives presents a number of questions in terms of the Republican agenda over the next two years, as well as the party's ability to be effective in working with the Senate to achieve that agenda. Although there were fewer changes in the Senate, the dynamics are sure to be markedly different, given that the Democrat majority has been whittled down from 14 seats to four.

Although all the new members may bring fresh perspectives to old issues, much education must be done to ensure that legislators are taking action based on the facts, rather than the myths, of public pensions. This includes making sure they have a clear understanding of the differences between public and private pensions.

Thus, while some organizations may be winding down in the final weeks before the start of a new year, we at NCPERS are rolling up our sleeves and sticking to business. In the words of former PepsiCo CEO Donald Kendall, the only place where success comes before work is in the dictionary.

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NCPERS believes the NRA regulations are a solution in search of a problem and a regulatory overreach. For governmental plans, the effective date has been extended to plan years beginning on or after January 1, 2013. To comply with the regulations, many public plans will have to devote considerable time, resources, and political capital to pursue legislative changes to their governing state statutes. NCPERS will be pursuing an exemption for public plans from the NRA regulations.

Finally, in the 112th Congress, NCPERS will pursue improvements to the HELPS law. The \$3,000 annual healthcare exclusion for public safety officers should be extended to surviving spouses; the annual amount of the exclusion should be indexed for inflation and made available to nonitemizers; and the statute should be amended to remove the reference to NRA, which, as described above, is caught in a complicated regulatory situation.

NCPERS wishes its members the best in the upcoming holiday season. We

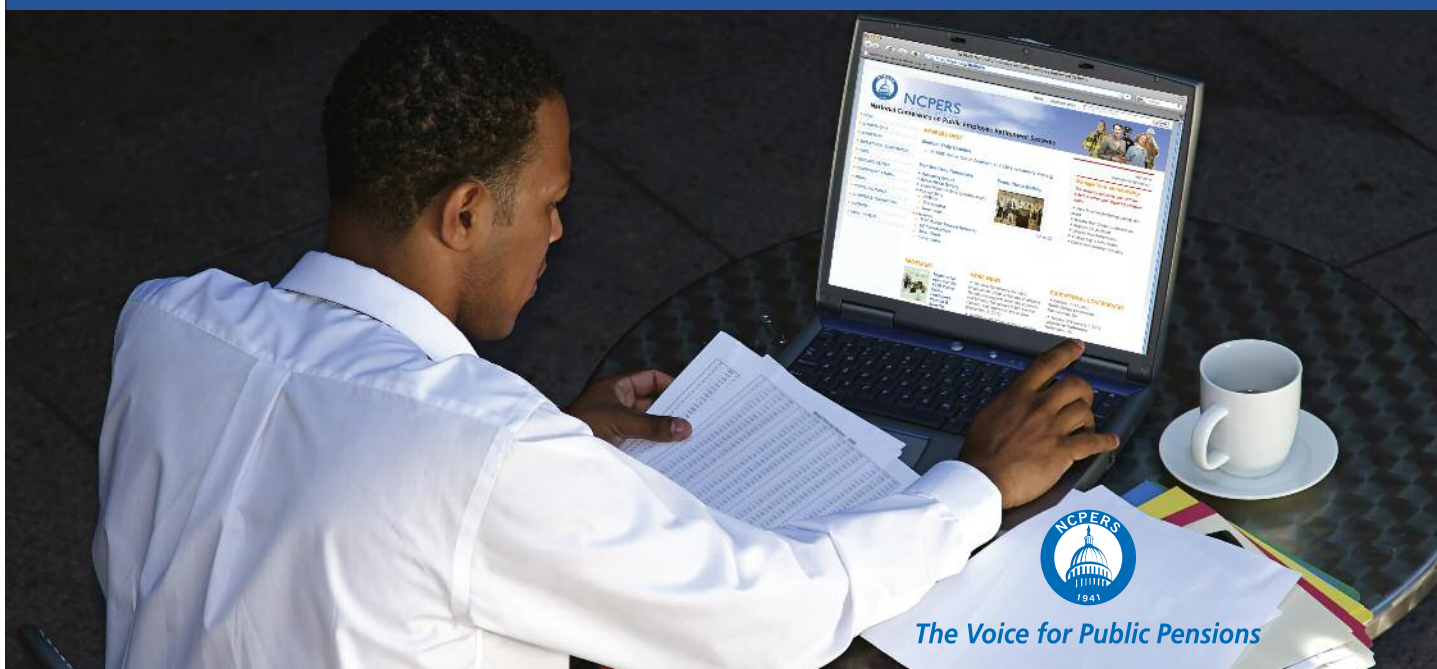
will have our hands full in 2011 and look forward to working with each of you on these priorities.

New Guidance on Unforeseeable Emergency Distributions from Deferred Compensation Plans

Recently issued Revenue Ruling 2010-27 provides additional guidance from the Department of the Treasury and the Internal Revenue Service (IRS) regarding which situations constitute

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an unforeseeable emergency under Internal Revenue Code §457(d)(1)(A)(iii), the statute governing distribution requirements for deferred compensation plans. Internal Revenue Regulation §1.457-6(c)(2)(i) defines *unforeseeable emergency* as

a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster); or *other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary.* (emphasis added)

This definition was echoed in the appendix to Revenue Procedure 2004-56, which includes a Model Amendment (Section 5.10). That procedure states that any other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the

participant may constitute an unforeseeable emergency under the law.

Although determining whether an unforeseeable emergency exists is a case-by-case facts-and-circumstances test, the regulation provides examples of circumstances that may constitute an unforeseeable emergency: imminent foreclosure or eviction from the participant's or beneficiary's primary residence; medical expenses, including nonrefundable deductibles and prescription drug medication; and funeral expenses of a spouse or dependent of a participant or beneficiary. However, college tuition payments and home purchases are specifically excluded from constituting an unforeseeable emergency.

It is important to remember that distributions for an "unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan" (Internal Revenue Regulation §1.457-6(c)(2)(ii)).

Revenue Ruling 2010-27 amplifies the statutory definition, regulations, and Model Amendment by describing three fact patterns and by providing the view of the Treasury-IRS on how the law would apply to each situation. The fact patterns and interpretations are as follows:

- **Situation 1.** Participant A provides written estimates of the repair cost and requests a distribution from Plan Y to pay for the cost of repairs to A's principal residence due to water damage in the basement. The expenses are not covered by insurance. **Analysis:** Although not specifically within the examples in the regulation, the regulations and Plan Y authorize distributions for other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary. Therefore, Plan Y may provide an unforeseeable emergency distribution to Participant A.
- **Situation 2.** Participant B provides written estimates of the expenses and requests a distribution from Plan Y for the funeral expenses of B's adult son, who is not a dependent of B. **Analysis:** This is not an example that is specifically mentioned in the regulations. However, it is a similar situation that is extraordinary and unforeseeable and that arises as a result of events beyond the control of the participant or the beneficiary. Therefore, Plan Y may provide an unforeseeable emergency distribution to Participant B.
- **Situation 3.** Participant C requests a distribution to pay accumulated credit card debt, which is not due to any extraordinary or unforeseen circumstance arising as a result of

events beyond the control of C. **Analysis:** The facts do not fit any specific examples contained in the regulation. Furthermore, they do not present a similar situation that is extraordinary or unforeseeable or that arises as a result of events beyond the control of the participant or beneficiary. Therefore, Plan Y may not provide

an unforeseeable emergency distribution to Participant C.

Bear in mind that plans are not required to make distributions for all situations that fit the definition of an unforeseeable emergency in order to meet the eligibility requirements under §457(d)(1)(A). However, distributions that are made may include the amounts necessary to

pay for local, state, or federal income taxes or penalties reasonably anticipated to result from the distribution.

Revenue Ruling 2010-27 and the fact patterns contained therein should be helpful to governmental 457(b) plans as they attempt to navigate the early distribution rules related to unforeseeable emergencies. ■

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