THE MONITOR
The Voice for Public Pensions
February 2011

Successful 2011 Legislative Conference Filled with Energy and Good Information

The 2011 NCPERS Legislative Conference, held January 30 to February 1, 2011, in Washington, D.C., focused on current issues facing public pensions and what to expect through the year. With more than 270 members in attendance, the conference was led by expert speakers who gave attendees the tools and resources necessary to educate members of Congress.

Opening remarks were made by NCPERS president Pat McElligott, who extolled the benefits of educating policymakers in Washington, D.C. Noting that for more than 30 years NCPERS has hosted the Legislative Conference, McElligott said the need for the Legislative Conference is greater now than ever before. And NCPERS members answered the call. “Take a moment to look around you,” he said. “Gathered at this year’s conference are more than 270 attendees from across the nation – from New York to California, Washington State to Florida.”

He noted that never before have public pensions been the target of such concerted attacks at the federal level. Even though no public plan has asked for assistance, a bill has been introduced in Congress to prevent a “bailout” of public pensions. A bill has been reintroduced in the 112th Congress that would place unprecedented reporting and filing requirements on public pensions. And Newt Gingrich, a former Speaker of the House, is advocating allowing states to declare bankruptcy so that they can avoid their obligation to sponsor public plans.

The keynote speakers were Donna Brazile and Dana Perino, who took the stage to provide a 2011 legislative and political outlook (see related article in this issue). The morning continued with a review and critique of the Dodd-Frank financial reform, an update on health care reform law, presentation of the NCPERS legislative agenda for the 112th Congress (see related article in this issue), and an analysis of the Public Employee Pension Transparency Act. The afternoon began with a panel from the Securities and Exchange Commission (SEC), whose members spoke on the activities and agenda items of the agency directly impacting public pension plans (see related article in this issue). The Honorable Bill Nelson (D-FL) was presented with the NCPERS Legislator of the Year award. Other topics discussed included an outlook on the current administration’s pension activities for 2011 (see related article in this issue) and NCPERS-commissioned polling and focus group data on public pensions; the all-day briefing session concluded with staff members of the Senate Finance and House Ways and Means Committees discussing agenda items that impact public pensions.

The last day of the conference, attendees were given the opportunity to discuss state issues and make congressional visits to meet with legislators on the Hill.

Brazile and Perino Put Politics in Perspective

It was “she said, she said” when Democratic strategist Donna Brazile and Dana Perino, press secretary to President George Bush, kicked off the NCPERS Legislative Conference on January 31, 2011, in Washington, D.C. The two women represent different ends of the political spectrum, but with regard to what lies ahead on the political horizon, they agreed more than they disagreed.

Their first bit of advice for Congress and the Administration: If you want to get it done, you need to get it done quickly. “I believe they have one year to get things done; then 2012 looms large,” observed Brazile.

"Entertainment will not be watching *Desperate Housewives* but watching the political primaries." Brazile also expressed skepticism about Republicans being able to find a candidate who is "big enough" to take on Obama.

Perino agreed that there is currently no Republican "heir apparent" to the presidency and warned of an even tighter window, more like six to nine months, in which to accomplish policy priorities. She said an extremely important date is just weeks away – March 4. That's the date when the continuing resolution to extend funding of the federal government expires. The timing also coincides with the need for a vote to raise the debt ceiling. "I think Congress will get it done but at a high price for Democrats in the form of spending cuts that the Republicans want," she said.

Perino noted that there is a lot of talk about cutting spending, but said Republicans won't do it "willy-nilly." "It's like the dog that caught the car," she said. "What do you do now?" In her view, the critical thing for Republicans will be to show voters they are delivering on public demands. "Voters are paying attention," she warned.

Brazile pointed to what she described as an increasingly polarized electorate – one that likes having a divided government. Brazile attributed this trend to the increasing number of independents who don't vote in the primary selection process. The end result, she said, is an "odd group" selected to run for office. "Their political philosophy is they don't agree on anything," she declared.

Brazile used the 2010 lame duck session of Congress as a positive example of the kind of leadership needed moving forward. With a congressional workload that includes reauthorization of the No Child Left Behind Act and the massive highway transportation bill, she stressed that both parties will have to come together to "find the middle." "The president needs to find the center and the Republicans who will meet him there," she asserted.

And while Republicans clearly won the day last November, Perino ruefully admitted that there are many ways they can "screw up" moving forward, whether through lack of patience or prudence, by holding hearings that don't deal with jobs, or by getting reckless with experimentation.

Both women concluded by stressing the importance of NCPERS members taking part in the legislative process by educating lawmakers about industry issues. "There are a lot of new people in Congress. Get to know them and their staff, and follow up with them when you return home," counseled Brazile. "They need to know about the dollars you contribute to your pension plan."

NCPERS 2011 Legislative Priorities

At the NCPERS Legislative Conference we heard from a number of speakers about the profound ways in which Congress has changed since the November elections. Many said that public sector pension plans would be under intense scrutiny by Congressional Republicans. This assertion has already been borne out by the facts.

What began as a three-pronged attack – The Public Employee Pension Transparency Act, Congressman Jason Chaffetz's (R-UT) resolution expressing the Sense of the House against a federal bailout of state and local pension plans, and the notion of expanding federal bankruptcy law to allow states to reorganize under bankruptcy protection – may now be two-pronged, but it should still concern public plans.

Expanding federal bankruptcy law is fast becoming a non-starter. House Majority Leader Eric Cantor (R-VA) and the National Governors Association oppose the proposal. Two House hearings also served to cast more cold water on the idea than build support for it. The first hearing was held on February 9 at the Oversight Committee's Subcommittee on TARP and Financial Services. The Judiciary Committee's Subcommittee on Courts, Commercial and Administrative Law, which has substantive jurisdiction over bankruptcy law, weighed in with a hearing on February 14. At the

hearing, full Committee Chairman Lamar Smith (R-TX) raised concerns about the constitutionality of the proposal and the implications on the bond market. His views were echoed by Subcommittee Chairman Howard Coble (R-NC) and the Ranking Minority Members of both the full and Subcommittee.

Meanwhile, the Public Employee Pension Transparency Act (PEPTA) was introduced by Congressman Devin Nunes (R-CA) with 40 original cosponsors the same day as the House Oversight Subcommittee hearing. The legislation, H.R. 567, would for the first time impose a federal reporting requirement on the funding status of state and local pension plans. Failure to comply with the reporting requirement would result in the loss of the plan sponsor's ability to issue bonds that are exempt from federal tax.

Under the proposed bill, pension liabilities would first be reported based on the economic assumptions and rates of return that each plan currently uses as its expected (long-term) return. In addition, plans would be required to report their pension liabilities on a rate of return based on a U.S. Treasury obligation yield curve. The Treasury yield curve method would produce dramatic increases in the calculation of unfunded liabilities of plans.

NCPERS strongly opposes PEPTA for a number of reasons, including that reporting pension liabilities based on the Treasury yield curve will result in projected economic returns that are unrealistic when compared to the diverse investments contained in pension plan portfolios. A pension plan would have to be invested 100 percent in Treasury bonds for the yield curve calculation to have any real world significance.

The last of the attacks is found in H. Res. 23. This non-binding Resolution states, "…it is the sense of the House of Representatives that (1) the Federal Government should not bailout state and local government employee pension plans and other post-employment benefit plans; and (2) State and local governments should immediately institute reforms to their employee pension plans, including replacing defined benefit plans with defined contribution plans.

Despite this difficult political environment, NCPERS will work to build support for improvements to the HELPS law and the tax code provision related to the waiver of the 10 percent penalty on certain pension distributions to public safety employees, which are found in Internal Revenue Code Sections 401(l) and 72(t)(10), respectively.

Under current law, state and local public safety officers may exclude up to $3,000 per year from gross income for health insurance premiums paid from certain pension distributions. HELPS II would expand the statute to include all public sector employees. It would also index the exclusion for inflation, allow surviving spouses to be eligible for the exclusion, allow non-itemizers to take the exclusion, and modify the language of the statute related to attaining normal retirement age.

Regarding Section 72(t)(10), NCPERS will work to broaden the definition of public safety employee to include federal public safety employees. Currently, only state and local public safety employees are eligible. In addition, the legislation would remedy two technical problems with the existing statute. The first issue involves public safety employees who began receiving a stream of substantially equal payments prior to enactment of the 10 percent waiver and would now like to modify the distribution amounts. The second issue relates to those who are required to remove all funds from their deferred retirement option plan upon separation of service and then subsequently roll the funds into a deferred compensation plan. In both cases, some or all of the protections of the penalty waiver are lost. NCPERS believes that this tax treatment was unintended and will seek to correct it.

Finally, we will continue to work for modifications to the May 2007 Treasury regulations on normal retirement age (NRA), which are interpreted by Treasury to require a specific age and not a years-of-service based calculation when a plan defines NRA. Historically, public

pension plans, particularly public safety plans, have used a years-of-service based NRA and have been permitted to do so by Treasury.

All of us must be vigilant over the next few months and years in order to protect public employee retirement plans. As always, I will keep you apprised of issues before the Congress.

SEC Activities Impacting Public Pensions

Representatives of the Securities and Exchange Commission (SEC) provided an overview of current and upcoming activities impacting public pensions at the recent NCPERS Legislative Conference.

Victoria Crane, assistant director, Division of Trading and Markets, updated the group on developments regarding municipal adviser registration under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under Section 975 of Title IX of the law, municipal advisers must register with the SEC, subject to the requirements of the Municipal Securities Rulemaking Board (MSRB). Last fall, the SEC adopted a temporary rule to satisfy the regulatory requirements; this temporary rule will expire at the end of 2011 at the latest, noted Crane.

Crane said that as of January 2011, close to 800 completed registrations had been filed. Last December, the SEC published new proposed rules for permanent regulation. The new rules establish a permanent regime along with record-keeping requirements with forms to be completed by municipal advisory firms (Form MA) and their employees (Form MA-I). Crane said the rule will require more detailed disclosure than the temporary requirement, with each application being reviewed by SEC staff, as well as requiring annual updates.

One of the most critical aspects of the proposed rule involves the definition of "municipal adviser." According to Crane, the statutory definition is very broad but excludes broker-dealers, attorneys offering legal advice, engineers offering engineering advice, investment advisers and commodity trading advisers. She added that there is also an exclusion proposed for accountants. Municipal advisers are divided into three categories: (1) financial advisers, (2) investment advisers, and (3) third-party marketers.

NCPERS is currently preparing industry comments to file with the SEC on behalf of the public pension community. Of particular concern is this definition of "municipal adviser," which potentially includes members of municipal and state retirement systems, who would then be required to register with the SEC.

"We're hoping that the new registration requirements will help with the conduct of municipal advisers," stressed Crane. She added that, as of January 1, 2011, the MSRB has imposed its own registration requirements, and she told NCPERS members to expect more proposals regarding municipal advisers from the MSRB this year. Furthermore, she noted that Dodd-Frank imposes fiduciary duty requirements that the SEC will be looking at later this year as well.

Robert Plaze, associate director, Division of Investment Management, first addressed changes necessitated by Dodd-Frank to the Investment Advisers Act, which governs public pension hiring of third-party investment advisers. He said the SEC issued proposed rules last fall that would, among other things, increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. To date, some 12,000 advisers have registered with the SEC.

Plaze pointed out that under the proposed rules, a hedge fund with more than $150 million in assets under management will now have to register with the SEC as an adviser, "even if it has only one client." That means disclosing the names of the businesses that service the funds, as well as information that might pose a conflict of interest, such as compensation for referrals. Advisers

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THE PATH TO RECOVERY

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under the $150 million threshold, those without US offices, and those that advise only venture capital funds would be exempted.

Another important recent development, said Plaze, is a new rule from the Financial Stability Oversight Council (FSOC) aimed at satisfying statutory obligations imposed by Dodd-Frank. Issued January 18, 2011, the notice of proposed rulemaking delineates the standards and procedures that will govern the authority of the FSOC to determine when and if a nonbank financial company must be supervised by the Federal Reserve Board because the company could pose a threat to the financial stability of the United States.

He also drew attention to the SEC's January 14, 2011, report to Congress regarding the need for enhanced resources for investment adviser examinations and enforcement. In the report, the Commission recommended that Congress consider three approaches to strengthening the Commission's investment adviser examination program:

- authorize the Commission to impose user fees on SEC-registered investment advisers to fund their examinations by the Office of Compliance Inspections and Examinations (OCIE);
- authorize one or more self-regulatory organizations (SROs) to examine, subject to SEC oversight, all SEC-registered investment advisers; or
- authorize the Financial Industry Regulatory Authority (FINRA) to examine dual registrants for compliance with the Investment Advisers Act.

"We addressed the question of whether broker-dealers have a fiduciary standard of care when providing advice and determined that the answer was 'yes,'" concluded Plaze.

Thomas Kim, chief counsel, Division of Corporation Finance, discussed developments arising from Dodd-Frank with regard to the executive compensation aspects of corporate governance. Most significant, he said, is the section that requires financial regulators to prohibit compensation that encourages "inappropriate risk." He said the SEC is working with the Federal Reserve and other agencies to develop a proposed rule addressing these issues for future publication.

Kim reported that the SEC had adopted its own rules on January 25, 2011, concerning shareholder approval of executive compensation and "golden parachute" compensation. The new rules specify that the say-on-pay votes required under the Dodd-Frank Act must occur at least once every three years, beginning with the first annual shareholders' meeting taking place on or after January 21, 2011. Companies also are required to hold a "frequency" vote at least once every six years in order to allow shareholders to decide how often they would like to be presented with the say-on-pay vote. Following the frequency vote, a company must disclose on an SEC Form 8-K how often it will hold say-on-pay votes.

He noted two "interesting" disclosure requirements regarding executive compensation: (1) the relationship between executive compensation paid and the performance of the issuer, and (2) the ratio between total compensation paid the CEO and total *median* compensation paid to all employees. "This is about pay parity," stressed Kim. "We're thinking about how to implement an appropriate way that will result in some information on pay parity."

Randall Roy, attorney, Office of Financial Responsibility, discussed the mandate under Dodd-Frank for the removal of any reference to credit rating agencies in regulations. "The goal is to reduce reliance by investors on ratings, but I'm not sure we will ultimately get there and it may not be feasible," he admitted. "There is a case to be made for regulating credit rating agencies."

Roy referred to the Credit Rating Agency Reform Act, passed by Congress in 2006, which required the SEC to establish guidelines for determining which credit rating agencies qualify as Nationally

Recognized Statistical Rating Organizations (NRSROs). However, he said, the rule also made it easier for other rating agencies to qualify. The law prohibits the SEC from regulating an NRSRO's rating methodologies.

Under the Dodd-Frank Act, said Roy, the SEC's enforcement mechanisms are enhanced, and a number of requirements on NRSROs are added that are immediately effective. He said the Commission will also need to adopt a number of new rules concerning the following:

- Annual reports on internal controls
- Conflicts of interest with respect to sales and marketing practices
- "Look-backs" when credit analysts leave the NRSRO
- Fines and penalties
- Disclosure of performance statistics
- Application and disclosure of credit rating methodologies
- Form disclosure of data and assumptions underlying credit ratings, among other things
- Disclosure about third-party due diligence
- Analyst training and testing
- Consistent application of rating symbols and definitions
- Specific and additional disclosure for ratings related to asset-backed security (ABS) products

He added that the Commission is currently seeking comments on its study of the feasibility and desirability of standardizing credit rating terminology, so that all credit rating agencies issue credit ratings using identical terms; standardizing the market stress conditions under which ratings are evaluated; requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity.

Administration Sees Public Pensions as Partner in Promoting Pension Security

"I want to start by recognizing the unique importance of what you do," stated Mark Iwry, senior adviser to the secretary and deputy assistant secretary for retirement and health policy, US Treasury, in his remarks at the NCPERS Legislative Conference.

"State and local governments are longtime bastions of pension benefits," he continued. "Their particular strength is defined benefit plans. The Administration strongly supports retirement security, and public pensions are an important part of that."

Iwry stressed the Administration's desire to work together with the public pension community in a partnership and dialogue. "We are listening. We won't always agree but we have similar challenges and goals," he said, "including the primary goal of promoting retirement security for American workers and their families."

Iwry noted that January 31, 2011, marks the end of the Internal Revenue Service's (IRS's) current Cycle E, in which government retirement plans may file for a determination letter from the agency. While not mandatory, a favorable determination letter provides a plan sponsor with protection from the risk that the IRS, upon audit of the plan, will determine that the written terms of the plan do not satisfy the applicable tax qualification requirements.

Iwry explained that some have suggested that it would be helpful to have a handbook summarizing the requirements to qualify for favorable tax treatment. "We're ready to cooperate and coordinate and the IRS is starting to put this together," he reported.

Iwry observed that while the tax code and the Employee Retirement Income Security Act (ERISA) define "government plan," no regulations have been published to interpret the exemption. He added that courts are responding on a case-by-case basis but, over time, there has been a growing requirement for determinations from groups with

"tenuous" ties to state and local governments. The end result, he said, is uncertainty. To address this, Iwry said Treasury and the IRS intend to publish guidance under the tax code. ERISA is also working with the Labor Department and the Pension Benefit Guaranty Corporation (PBGC) on a common definitional approach. He assured NCPERS members that the agencies will solicit "extensive comments" before adopting any new regulations.

Iwry then addressed the issue of "normal retirement age" (NRA), along with vesting and definitely determinable benefits requirements. Implementation of the IRS/Treasury rules defining NRA has been postponed until 2013 to give government plans more time to comply. NCPERS has argued that public plans should be exempted from the NRA regulations. While maintaining that it was "premature" to comment, Iwry said the input from NCPERS was helpful.

NCPERS will continue to work with Treasury to ensure a satisfactory resolution to the NRA issue. ■

Hank H. Kim, Esq.
Executive Director
& Counsel

You've read the headlines:

"Public Employee Pension Debt Explodes"
"State's Pension Gap Looms Large"
"Studies Show Grim Outlook for Public Plans"

As is so often the case with the media, the public has largely been hearing one side of the story – and it generally isn't ours. Now that is about to change.

Over the last six months, NCPERS has invested in obtaining some hard data to help us better understand just how knowledgeable Americans are about public pensions, what their attitudes are toward public employees, and what kinds of messages resonate most strongly with them regarding public pension funding.

Not surprisingly, issues involving public pensions are not currently top of mind with most Americans. Instead, jobs and the economy are what keep them awake at night. That's the good news. The bad news, our research shows, is that those who are familiar with the effect public employee pensions have had on state and local budgets tend to have a negative view of public pensions.

We're going to work to change that. Our research points to a number of messaging opportunities that bode well for success. It also shows us that when given more information about the issue, Americans respond in a largely positive way, especially when we put a "face" on the issue: your face – and the faces of teachers, fire fighters, police, and other public employees who do so much to improve the quality, safety, and security of all our lives.

Our research data are critically important because they will provide the platform for us, in the days ahead, to craft the strongest messages to use in educating people about the facts about public pensions and the importance of retirement security for all Americans. But although our polling data seem to point toward some opportunities, this doesn't mean we've won a reprieve and the public pension community can relax. In fact, it means we need to redouble our efforts to educate all stakeholders, including our own members, as well as the public and policymakers, on the advantages of public pensions.

It's a long and winding road ahead, with battles to be won and sometimes lost. In the end, winning the war is what really counts, and, with your help, that's exactly what we plan to do.

United States Senate
WASHINGTON, DC 20510–0905

BILL NELSON
FLORIDA

January 31, 2011

National Conference on Public Employee Retirement Systems
444 N. Capitol Street NW, Suite 630
Washington, D.C. 20001

Dear Friends:

Thank you so much for honoring me with the Legislator of the Year award. I apologize that I cannot be with you in person, but I would like to extend my sincere appreciation for this honor and thank you for the hard work that you do on behalf of public employees.

Florida is a state that benefits greatly from the work of the National Conference on Public Employee Retirement Systems. Our seniors, many of whom served local communities for decades as public employees, depend on pensions for life after retirement. When our senior citizens are financially secure and can spend their retired years fulfilled and active, our entire society benefits.

In these tough economic times the work of the NCPERS is as important as ever. I encourage you to continue with the same tenacity you have shown for 70 years now. And I intend to stand beside you, doing the same in Congress. This session I will reintroduce a bill designed to protect the pensions of public safety employees. Under my law, folks like firefighters and paramedics would not have to pay a 10 percent tax penalty on early pension distributions if they retire before the age of 55. Hopefully this step is the first of many that Congress will take this session to protect public pensions.

Thank you again for this wonderful honor, and God Bless.

Sincerely,

Bill Nelson

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