THE MONITOR

The Voice for Public Pensions

November 2009

Congress Holds Hearings on Credit Ratings Agencies

On September 30, the Capital Markets, Insurance, and Government Sponsored Enterprise Subcommittee of the House Financial Services Committee and the House Oversight and Government Reform Committee convened separate hearings on credit ratings agencies and how their businesses affected the recent economic downturn.

The House Financial Services subcommittee hearing was to discuss Chairman Paul Kanjorski's (D-PA) discussion draft of the "Enhanced Accountability and Transparency in Credit Rating Agencies Act." The heads of the three largest credit ratings agencies—Standard & Poor's, Moody's Corporation and Fitch Inc.—were impaneled for the hearing, as were representatives from the Securities and Exchange Commission and the CFA Institute Centre for Financial Market Integrity. Rep. Kanjorski indicated that he hoped to see provisions from his discussion draft incorporated into the larger regulatory reform bill that Full Committee Chairman Barney Frank (D-MA) plans to move through committee this fall.

According to Dan Gallagher, Co-Acting Director of the Division of Trading and Markets at the SEC, Poor performance by highly rated securities resulted in substantial investor losses and market turmoil which severely damaged the financial markets. As we work to restore the health of the markets, it is vital that we take further steps to improve the integrity and transparency of the ratings process, promote competition among rating agencies, and give investors the appropriate context for evaluating ratings." Gallagher went on to testify that SEC staff examinations of three credit rating agencies found that there were "serious questions about the Nationally Recognized Statistical Rating Organizations' management of conflicts of interest, internal audit processes, and due diligence activities."

Moody's Corporation CEO Raymond McDaniel testified that the company supports provisions that would increase the transparency of their ratings performance and ratings methodologies. As well as increased disclosures in the industry on assumptions used in ratings, potential limitations of ratings, and potential volatility of ratings. However, McDaniel said, the discussion draft also includes some provisions that would, if enacted, undermine the attributes of credit ratings that are valued by market participants and authorities.

In a hearing that same day held by the House Committee on Oversight and Government Reform, CalPERS Senior Investment Officer Eric Baggesen told the committee that the credit rating agencies' standards of business conduct are "opaque, there are no agreed guidelines, and their revenues are based on a fundamental conflict of interest. These organizations have privileged access to issuer information, and operate under license within a narrow oligopoly." Baggesen went on to argue that the failure of the credit ratings agencies materially affected CalPERS' assets.

"As one of the largest institutional global investors, CalPERS has suffered from the impact of systemic losses both directly from the credit crisis, and the economic downturn which this accelerated," he said.

Lawmakers at the Committee on Oversight and Government Reform hearing were particularly interested in the testimony of two former Moody's Corp. officials who claimed that the rating agency retaliated against employees who

raised concerns about the credit ratings given structured securities that later proved to be far less valuable than the ratings implied. Ilya Eric Kolchinsky, a former managing director of Moody's Investor Service who said he lost his job after raising concerns about ratings, said that the rating agencies should face increased liability, but that such liability should "come hand in hand" with specific standards for the organizations to follow. Having specific standards in place would prevent unnecessary legal action by investors who had made mistakes, he said.

Rep. Kanjorski has not yet introduced legislation that would further regulate the credit ratings industry.

IRS Extends Implementation Date for Normal Retirement Age Regulations

The Internal Revenue Service and Treasury intend to extend the time by which a governmental plan must comply with final regulations on distributions from a pension plan upon attainment of normal retirement age (NRA) beyond the previously announced date of January 1, 2011. A new notice, Notice 2009-98, was issued indicating that the time by which a governmental plan must comply with final regulations on distributions from a pension plan upon attainment of normal retirement age will again be pushed back. These regulations were first published in the Federal Register on May 22, 2007. Taking into account this new extension, the NRA regulations will be effective for a governmental plan (as defined in § 414(d) of the Internal Revenue Code) for plan years beginning on or after January 1, 2013.

This notice does not change the effective date of the NRA regulations for a plan that is not a governmental plan or modify the relief previously provided in Notice 2007-69.

Section 411(a)(8) of the Code provides that the term "normal retirement age" means the earlier of (A) the time a plan participant attains normal retirement age under the plan or (B) the later of age 65 or the fifth anniversary of the time a plan participant commenced participation in the plan. A plan's normal retirement age is relevant for a number of purposes, including for purposes of determining the date at which a participant is eligible to receive his or her normal retirement benefit and calculating the amount of the benefit received.

The NRA regulations require a pension plan's normal retirement age to be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. The NRA regulations provide that a normal retirement age of 62 or later (or age 50 or later, in the case of a plan in which substantially all of the participants are qualified public safety employees (within the meaning of § 72(t)(10)(B))) is deemed to satisfy this requirement, and a normal retirement age lower than 55 is presumed not to satisfy the requirement unless the Commissioner determines otherwise on the basis of facts and circumstances. Whether a normal retirement age that is at least 55 but below 62 satisfies the requirement is based on facts and circumstances.

The NRA regulations were generally effective May 22, 2007, with a later effective date for governmental plans and certain collectively bargained plans. For governmental plans, the NRA regulations were originally effective for plan years beginning on or after January 1, 2009. The effective date was then pushed back to plan years beginning on or after January 1, 2011.

NCPERS, along with other interested parties, continues to seek guidance from the IRS and Treasury on how the regulations affect government plans and plan participants.

IRS Announces Pension Plan Limits for 2010

The Internal Revenue Service on October 15 announced cost of living adjustments applicable to dollar limitations for pension plans and other items for Tax Year 2010.

Section 415 of the Internal Revenue Code provides for dollar limitations

on benefits and contributions under qualified retirement plans. Section 415(d) requires that the Commissioner annually adjust these limits for cost of living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments under Section 415. Under Section 415(d), the adjustments are to be made pursuant to adjustment procedures which are similar to those used to adjust benefit amounts under Section 215(i)(2)(A) of the Social Security Act.

The limitations that are adjusted by reference to Section 415(d) will remain unchanged for 2010. This is because the cost-of-living index for the quarter ended September 30, 2009, is less than the cost-of-living index for the quarter ended September 30, 2008, and, following the procedures under the Social Security Act for adjusting benefit amounts, any decline in the applicable index cannot result in a reduced limitation. For example, the limitation under Section 402(g)(1) on the exclusion for elective deferrals described in Section 402(g)(3) will be $16,500 for 2010, which is the same amount as for 2009. This limitation affects elective deferrals to Section 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

Effective January 1, 2010, the limitation on the annual benefit under a defined benefit plan under Section 415(b)(1)(A) remains unchanged at $195,000. For participants who separated from service before January 1, 2010, the limitation for defined benefit plans under Section 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2009, by 1.0000.

The limitation for defined contribution plans under Section 415(c)(1)(A) remains unchanged for 2010 at $49,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of Section 415(b)(1)(A). After taking into account the applicable rounding rules, the amounts for 2010 are as follows:

- The limitation on the exclusion for elective deferrals described in Section 402(g)(3) remains unchanged at $16,500.
- The annual compensation limit under Sections 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) remains unchanged at $245,000.
- The dollar limitation under Section 416(i)(1)(A)(i) concerning the definition of key employee in a top-heavy plan remains unchanged at $160,000.
- The limitation used in the definition of highly compensated employee under Section 414(q)(1)(B) remains unchanged at $110,000.

The dollar limitation for catch-up contributions to an applicable employer plan other than a plan described in Section 401(k)(11) or Section 408(p) for individuals aged 50 or over remains unchanged at $5,500. The dollar limitation for catch-up contributions to an applicable employer plan described in Section 401(k)(11) or Section 408(p) for individuals aged 50 or over remains unchanged at $2,500.

The annual compensation limitation under Section 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost of living adjustments to the compensation limitation under the plan under Section 401(a)(17) to be taken into account, remains unchanged at $360,000.

The limitation on deferrals under Section 457(e)(15) concerning deferred compensation plans of state and local governments and tax-exempt organizations remains unchanged at $16,500.

The compensation amounts under Section 1.61 21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes remains unchanged at $95,000. The compensation amount under Section 1.61 21(f)(5)(iii) remains unchanged at $195,000.

For more information on the Service's 2010 pension plan limits,

please visit the IRS website at http://www.irs.gov/newsroom/article/0,,id=214321,00.html.

NCPERS Comments on SEC Proposed Rule on Political Contributions by Certain Investment Advisors

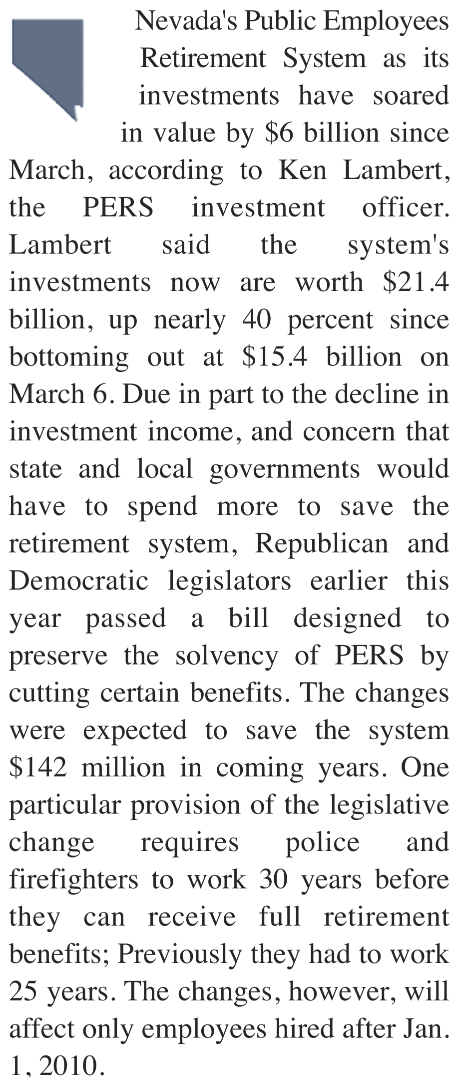
On October 6, NCPERS submitted comments to the Securities and Exchange Commission (SEC) on the SEC Proposed Rule on Political Contributions by Certain Investment Advisers. Our comments focused on the proposed Ban on Using Third Parties to Solicit Government Business. The scrutiny of third-party marketers has increased recently due to reports that marketers in certain states have engaged in illegal activity in order to ensure that their clients receive business from state and local pension funds. NCPERS maintains the position that the majority of third-party marketers are legitimate businesses that conform to current rules and provide valuable services to pension funds.

In comments filed with the SEC, NCPERS Executive Director Hank Kim stressed two points: that, rather than an outright ban on third-party solicitation, the most effective method of reducing or eliminating undue influence is by having multiple trustees on public pension boards, and that the proposed ban on third-party solicitation would deprive public pension funds awareness of and access to smaller, less established firms that frequently use third-party marketers for their products and offerings.

NCPERS will continue to report on the proposed ban as it makes its way through the regulatory process. To view NCPERS' comments to the SEC, please visit http://www.ncpers.org/files/NCPERS_S7-18-09.pdf.

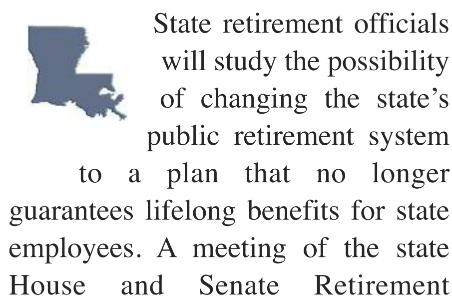
In the STATES

Nevada



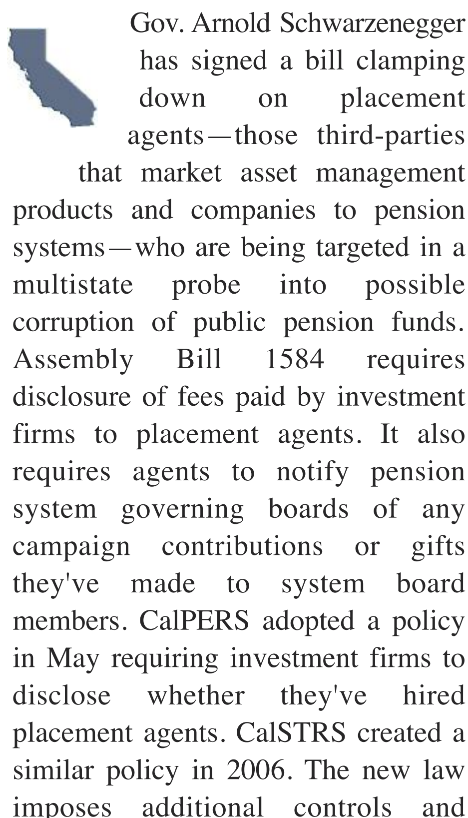
Nevada's Public Employees Retirement System as its investments have soared in value by $6 billion since March, according to Ken Lambert, the PERS investment officer. Lambert said the system's investments now are worth $21.4 billion, up nearly 40 percent since bottoming out at $15.4 billion on March 6. Due in part to the decline in investment income, and concern that state and local governments would have to spend more to save the retirement system, Republican and Democratic legislators earlier this year passed a bill designed to preserve the solvency of PERS by cutting certain benefits. The changes were expected to save the system $142 million in coming years. One particular provision of the legislative change requires police and firefighters to work 30 years before they can receive full retirement benefits; Previously they had to work 25 years. The changes, however, will affect only employees hired after Jan. 1, 2010.

Louisiana



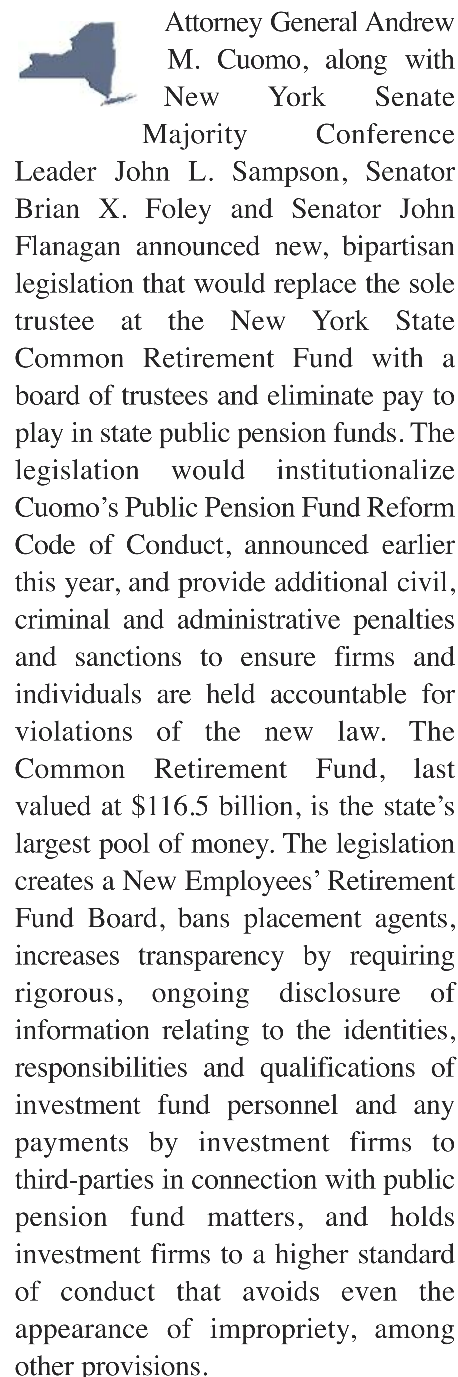
State retirement officials will study the possibility of changing the state's public retirement system to a plan that no longer guarantees lifelong benefits for state employees. A meeting of the state House and Senate Retirement committees will be looking at defined-contribution plans, which are similar to 401(k)s and require employees to manage their own investments. Employees retire with what they and their employer contribute to the system, along with investment earnings or losses. The meeting is based on a study resolution by House Speaker Jim Tucker, which seeks to determine the feasibility of establishing a defined contribution plan for all new employees hired on and after July 1, 2010, in the four state public retirement systems. Current employees and retirees would not be affected by any plan changes.

California



Gov. Arnold Schwarzenegger has signed a bill clamping down on placement agents—those third-parties that market asset management products and companies to pension systems—who are being targeted in a multistate probe into possible corruption of public pension funds. Assembly Bill 1584 requires disclosure of fees paid by investment firms to placement agents. It also requires agents to notify pension system governing boards of any campaign contributions or gifts they've made to system board members. CalPERS adopted a policy in May requiring investment firms to disclose whether they've hired placement agents. CalSTRS created a similar policy in 2006. The new law imposes additional controls and extends them to all public pension funds in California.

New York



Attorney General Andrew M. Cuomo, along with New York Senate Majority Conference Leader John L. Sampson, Senator Brian X. Foley and Senator John Flanagan announced new, bipartisan legislation that would replace the sole trustee at the New York State Common Retirement Fund with a board of trustees and eliminate pay to play in state public pension funds. The legislation would institutionalize Cuomo's Public Pension Fund Reform Code of Conduct, announced earlier this year, and provide additional civil, criminal and administrative penalties and sanctions to ensure firms and individuals are held accountable for violations of the new law. The Common Retirement Fund, last valued at $116.5 billion, is the state's largest pool of money. The legislation creates a New Employees' Retirement Fund Board, bans placement agents, increases transparency by requiring rigorous, ongoing disclosure of information relating to the identities, responsibilities and qualifications of investment fund personnel and any payments by investment firms to third-parties in connection with public pension fund matters, and holds investment firms to a higher standard of conduct that avoids even the appearance of impropriety, among other provisions.

Executive Director's Corner

Hank H. Kim, Esq.
Executive Director
& Counsel

While this off-year gubernatorial elections in certain states don't have the political significance that last year's national elections did, there are still important races that may have implications for the public pension community. In Virginia and New Jersey, voters will have to decide who they want representing them in the Governor's mansion. The Virginia election—for a term-limited open seat—pits Democrat Creigh Deeds against Republican Bob McDonnell, while New Jersey has incumbent Democratic Governor Jon Corzine challenged by Republican Chris Christie.

While many are suggesting that the races in these two states are referendums on President Obama's first year in office, there should be more analysis than that. To the extent that the economy has not completely turned around, and there is continued volatility in the markets, democrats have seen approval ratings slide. And that is indicated by the lead the Republican candidate has in the Virginia election and the virtual tie that Gov. Corzine is in with his challenger.

But more importantly is what happens in these two states come 2010. Regardless of who wins in Virginia, the state will have a new Governor. And even if Gov. Corzine manages to hold on to his seat in New Jersey, he will have no clear mandate.

So, how does this affect the public pension community? If the economy remains stagnant, and distinct volatility remains a constant in the markets, those influences may adversely affect the assets public pensions hold. And if pension funds don't return to levels seen prior to the economic meltdown, governors may find themselves under increased pressure to seek alternative retirement plans for state workers. In the case of Virginia, both candidates have advocated for keeping promises to current workers, but would not rule out changing the rules for future state workers in order to keep the pension fund solvent. In New Jersey, which just last year saw changes to the system for future workers, a new or embattled governor may seek to cut even more.

So, while these gubernatorial elections may or may not be a bellwether for next year's mid-term House and Senate elections, they certainly may give us a clue as to what we can expect on the issue of pensions in state legislatures.

THE
MONITOR The Latest in Legislative News

The Monitor is published by the National Conference on Public Employee Retirement Systems.
Website: www.NCPERS.org • E-mail: legislative@NCPERS.org

The Voice for Public Pensions

444 North Capitol Street, NW, Suite 630 • Washington, DC 20001 • 1-877-202-5706 • (202) 624-1439 (fax)