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National Conference on Public Employee Retirement Systems

NCPPERS: Who We ARE

The National Conference on Public Employee Retirement Systems (NCPPERS) is the largest trade association for public-sector pension funds, representing more than 550 funds throughout the United States and Canada. We are a unique network of public trustees, administrators, public officials, and investment professionals who collectively manage approximately $3 trillion in pension assets. Our core missions are federal Advocacy, conducting Research vital to the public pension community, and Educating pension trustees and officials—it’s who we ARE.

Who do we benefit? The approximately $3 trillion in public pension assets in the United States is managed on behalf of 7.3 million public retirees and 14.5 million active public servants who provide vital services, such as law enforcement, fire and rescue, education, health care, and more, to our communities. Currently, NCPERS member pension funds provide a modest retirement benefit—an average of $21,800 per year—that helps afford a secure retirement for our public servants and heroes.

Public pensions are financially sound and good for the economy. On average, the nation’s public pension plans are well-funded. Almost all public plans require employee contributions, and all public plans invest their assets in growth vehicles that earn additional income. According to a recent National Institute on Retirement Security study, state and local pension plans had a total economic impact of more than $358 billion, supported more than 2.5 million American jobs, and provided more than $57 billion in annual federal, state, and local tax revenue in a single year. Each taxpayer dollar invested in state and local pensions supported $11.45 in total economic activity, while each dollar paid out in benefits supported $2.36 in economic activity.

Public pensions are regulated by state and federal laws. All public plans are governed by federal and state laws that regulate how those plans are established and the level of benefits they can provide. Public plans are also governed by comprehensive financial reporting standards established by the Governmental Accounting Standards Board (GASB). These standards provide the framework for the annual financial audits that most governments contract to independent accounting firms. Because credit rating agencies pay close attention to the auditor’s report in assessing a government’s credit quality, there is significant incentive to adhere to the GASB’s standards. Although public plans are not subject to many of the provisions of the federal Employee Retirement Income Security Act (ERISA) of 1974, state fiduciary laws governing public plans often reflect ERISA’s language.
The Secure Choice Pension

On September 14, 2011, NCPERS unveiled the Secure Choice Pension (SCP) plan, a new proposal for a public – private partnership to restore retirement security to the private sector. The SCP is aimed at enhancing retirement security in the private sector by providing workers who currently do not have a pension plan with a guaranteed, lifetime retirement income that would be immune to stock market fluctuations and economic downturns.

At the same time, the proposed SCP would provide the flexibility and portability that the increasingly mobile private workforce needs, while spreading investment risks and costs over large pools of plan participants and employers.

As envisioned by NCPERS, each state would establish its own SCP to be administered by a board of trustees made up of public and private representatives. Private sector employers would join an SCP, allowing their employees to participate in that SCP. Both the participating employers and employees would make regular contributions to the SCP.

SCPs would give participants the benefits of lower costs because of the efficiencies and economies of scale available to large pension plans. It would also give private sector participants the benefits of higher returns because SCP assets would be pooled and managed by professionals.

At retirement, the SCP would provide participants with a guaranteed pension payment for life with the opportunity for increased payments in good economic times. Plan participants would enjoy a guaranteed minimum retirement income but the SCP’s trustees would be able to declare a “dividend” during a strong economy that would increase that benefit.

At best, most private sector employees have only two of the three legs of the retirement stool. They have Social Security and some have personal savings, which include 401(k)s. SCPs are a way to bring back the third leg of the stool for those workers who currently do not have a pension. Even workers who diligently save can see their nest eggs significantly diminished by an unexpected economic downturn, and private sector companies – especially small employers – are increasingly reluctant to bear all of the risk a traditional defined benefit pension plan entails.

The SCP is a desperately needed alternative. It would address the private sector retirement security crisis through a guaranteed, affordable, sustainable pension that draws on the lessons learned from successful public pension plans.

The SCP is a powerful alternative whose time is now.
NCPIERS supports the Secure Choice Pension proposal and seeks to introduce enabling legislation. While the SCP would be a state-based program, it would implicate some ERISA rules and the federal tax code. Thus, enabling federal legislation that would provide waivers from certain provisions of ERISA and the IRC would be necessary.

- Retirement security is a problem for all Americans. Pension plans are the most effective and efficient means of ensuring an economically viable retirement. Numerous surveys show that the vast majority of American workers would prefer a pension in addition to personal savings that include 401(k)s and Social Security to guarantee financial security in retirement.

- The proposed Secure Choice Pension (SCP) plan allows private companies and individuals to participate in a state-sponsored pension plan for the private sector. This model extends to all Americans the benefits of a proven, cost-effective retirement system that will provide guaranteed income for life in retirement.

- What would be the benefits of SCPs?
  - Businesses: Small to mid-size businesses can now compete with larger companies in recruiting and retaining qualified employees through an attractive retirement option which they currently cannot afford to offer. For large businesses, participation reduces their retirement plan administration costs.
  - Taxpayers: SCPs will not cost taxpayers state money because they will be funded entirely by employer and employee contributions. In fact, taxpayers will benefit because an expanded and strong middle class with financial security in retirement will decrease the strain of public assistance programs on state budgets.
  - Participants: Individuals will have a new secure choice for retirement that offers them a guaranteed monthly income stream when they retire and an attractive option beyond 401(k)s and other self-directed plans.
  - States: A state with an SCP would have a competitive advantage when trying to attract out-of-state businesses. Furthermore, a state with a strong pension system for its citizens upon retirement will benefit from their increased economic activity. Studies show that for every pension dollar paid out, $2.36 in economic activity is generated. Nearly 90 percent of individuals retire in the communities in which they worked. Without an adequate retirement income, a state's retiree population cannot continue to be active consumers and taxpayers, and will be increasingly at risk of relying on the publicly-funded safety net.
The Public Employee Pension Transparency Act

During the last Congress, legislation was introduced that would for the first time impose a federal reporting requirement on the funding status of state and local pension plans – H.R. 567, which was introduced by Representative Devin Nunes (R-CA), and S. 347, which was introduced by Senator Richard Burr (R-NC). The legislation is expected to be reintroduced in the current 113th Congress.

Fulfilling the reporting requirement would be the responsibility of the plan sponsor; that is, the state or municipal government. 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.

Reporting would be required using two distinct methods. First, pension liabilities would be reported based on the economic assumptions and rates of return that each plan currently uses as its expected (long-term) return. Second, all plans that are not fully-funded would be required to report their pension liabilities on a rate of return based on a U.S. Treasury obligation yield curve. The Treasury obligation yield curve method would predictably produce a dramatic increase in the correlated calculation of unfunded liabilities of plans.

NCPERS opposes the Public Employee Pension Transparency Act.
Medicare Payroll Tax Voluntary Opt-In Proposal

Certain public employees hired on or before March 31, 1986 may not be eligible for premium-free Medicare Hospital Insurance (HI), which is commonly known as Medicare Part A.

The Consolidated Omnibus Budget Reconciliation Act of 1985 requires employees who began working for a state or local government after March 31, 1986 to pay the Medicare HI tax. However, the act did not make the tax mandatory for workers hired before that date. Under the Omnibus Budget Reconciliation Act of 1990, the Medicare tax was extended to those state and local government workers who were not covered by a retirement plan through a current employer. Even with this change, about two percent of state and local workers do not pay the Medicare HI tax today.

All states have agreements with the federal Social Security Administration (Section 218 agreements) that designate which employee positions will be covered by the Medicare HI payroll tax, including some positions held by employees hired on or before March 31, 1986. These agreements can be modified and new positions added by a referendum of employees in separate retirement groups, but individuals cannot opt in on their own.

Unless the affected public-sector employees build Medicare credit quarters through other employment or can qualify through their spouses, they are ineligible for the Medicare Part A coverage that most Americans receive. Paying the Medicare HI tax for 10 years (40 credit quarters) generally qualifies workers for free Medicare Part A coverage; paying the tax for at least 7½ years (30–39 credit quarters) qualifies workers for a reduced Part A monthly premium.

Upon reaching age 65, otherwise ineligible individuals may buy into Medicare Part A coverage by paying monthly premiums. The Part A premiums are $450 per month for 2012 ($5,400 per year).

NCPERS supports legislation to allow active public-sector employees to voluntarily opt into the Medicare payroll tax system.
Tax Reform and Retirement Savings

Tax expenditures will be under the microscope during consideration of comprehensive tax reform this year. One area that was discussed in the president’s National Commission on Fiscal Responsibility and Reform (Simpson-Bowles Plan) is tax-preferred contributions to both defined benefit and defined contribution retirement plans, which combined cost almost $640 billion over a five-year period, according to the Joint Committee on Taxation. The cost is computed as the income taxes forgone on current tax-excluded pension contributions and earnings, less the income taxes paid on current pension distributions.

The expenditure of $640 billion over five years, or $1.28 trillion over 10 years, is hard to ignore for purposes of revenue generation during debate on tax reform. Although eliminating the tax-preferred treatment of pension contributions is not politically attainable or sound economics in the long term, reductions to the annual contribution limits could certainly be on the table.

NCPERS supports maintaining the current tax treatment of pension contributions and does not support reductions in the annual contribution limits.
Normal Retirement Age

In May 2007, the Department of the Treasury and the Internal Revenue Service (IRS) promulgated regulations that would define the term normal retirement age for pension plans. Specifically, the regulations provide that pension plans must have an age-based criterion for normal retirement.

Most pension plans for public employees provide eligibility for non-disability retirement based on years of service, not on attainment of a certain age. Therefore, in order to comply with the 2007 regulations, many public plans may be forced to devote considerable resources to pursuing changes in governing state laws.

Public plans protested the new regulations in formal comments to the Treasury and IRS and in subsequent meetings attended by NCPERS and other national groups. As a result, the effective date of the regulations was pushed back multiple times and, in early 2012, the Treasury and IRS issued Notice 2012-29, which announced their intention to issue revisions to the 2007 regulations in order to clarify their scope. In particular, the Notice stated that the revised regulations would clarify that governmental plans not providing for in-service distributions before age 62 do not need to have a definition of normal retirement age. In addition, the Notice stated that the revised regulations would modify the age 50 safe harbor provision for public safety employees to ensure its application in instances where those employees are only a subset of a plan that includes other public-sector employees.

NCPERS supports the direction of Treasury Notice 2012-29 and will continue to work with the Treasury Department and IRS on the revised regulations.
Definition of Governmental Plan

In November 2011, the IRS issued an Advance Notice of Proposed Rulemaking (ANPRM) which announced that the Department of the Treasury and IRS plan to issue regulations defining the term *governmental plan* under Internal Revenue Code (IRC) Section 414(d). The ANPRM also included a draft notice of proposed rulemaking and invited public comment.

NCPERS joined with a number of other national groups in submitting comments. Our joint letter focused on the creation of safe harbors, grandfather treatment, transition-related issues, and certain practical administrative concerns.

The basic structure of the ANPRM, which is the initial step in creating the first set of federal regulations under IRC Section 414(d), is a facts and circumstances test. Of particular interest is the test that would determine whether an entity is an “agency or instrumentality of a state or a political subdivision of a state.” The ANPRM contains a test for this definition that is based on five major factors and eight other factors. These factors include most of the areas of inquiry that would logically be investigated in a determination of whether an entity is a governmental plan, such as state or political subdivision control of the entity, state responsibility for the general debts and liabilities of the entity, delegation of sovereign powers, treatment as a governmental entity for federal tax purposes, and whether the entity is determined by state law to be an agency or instrumentality. However, there is no certainty that four or five or even six factors would be enough for an entity to satisfy the new federal regulatory test outlined in the ANPRM. More clarity is needed.

At a public hearing held by the IRS in the summer, 14 witnesses testified regarding the ANPRM. Five of the witnesses focused on the controversy surrounding whether charter schools would be eligible for governmental plan status under the ANPRM’s factor-based test. In the question-and-answer portion of the hearing, the IRS seemed to give serious consideration to adding an example to the ANPRM in its next iteration that would describe the relevant factors of charter schools – open enrollment, free tuition, state regulation and funding – and conclude that this type of entity would meet the definition of a governmental plan.

NCPERS will continue to work with the Treasury Department and the IRS as they develop proposed regulations on the definition of a government plan.
Employer Pick Ups

Under IRC Section 414(h)(2), governmental entities may “pick up” their employees’ pension contributions and, in effect, transform the employee contributions into employer contributions, provided certain conditions are met. Employee contributions that are picked up by the employer are not includible in the employees’ gross income until distributed and are considered pretax employer contributions.

Revenue Ruling 2006-43 provides the rules for a pick up. The rules do not permit participating employees to have a cash or deferred election right with respect to designated employee contributions as of the date of the pick up. Therefore, participating employees must not be allowed to opt out of the pick up treatment or receive the contributed amounts directly instead of having them paid by the employing unit to the plan. This issue is a current focus of the Department of the Treasury, the IRS, and Congress. The issue was triggered by a private letter ruling (PLR) request. Federal legislation, H.R. 2934 (112th Congress), was also introduced.

The PLR sought approval to create a new and reduced tier of defined benefit within an existing defined benefit plan and make the new tier available to existing employees. The employer would continue to pick up the contributions of existing employees, but the employee contribution rate in the new tier would be less than the rate in the existing tier. Existing employees who choose the new plan would see their salaries increased by virtue of the lower contribution rate. Hence, by being able to choose between the existing and new plans, existing employees would have a cash or deferred election.

NCPERS will continue to provide input to the Treasury Department, the IRS, and Congress on this important topic.
Definition of Municipal Advisor

On January 6, 2011, the Securities and Exchange Commission (SEC) issued a proposed rule that defined the term *municipal advisor*. The proposed definition included appointed, but not ex officio, members of a governing body of a municipal entity. The SEC’s rationale for the inclusion of these board members is that “the Commission is concerned that appointed members, unlike elected officials and elected ex officio members, are not directly accountable for their performance to the citizens of the municipal entity.”

The SEC has received numerous comment letters on this proposed definition, including a letter from NCPERS. The thrust of the NCPERS comments is that pension trustees receive advice in connection with fiduciary duties and should not be confused with those providing investment advice or be required to register as a municipal advisor. NCPERS is concerned that unpaid pension trustees would potentially be deterred from service or would likely want the municipality to provide legal or other assistance with registration and related compliance requirements. We understand that the SEC is giving careful consideration to the comment letters and would like to issue final regulations in 2013.

NCPERS supports the issuance of final rules by the SEC that remove pension trustees of governmental plans from inclusion in the definition of municipal advisor.